PROCEEDINGS

OF THE

THIRTY-FOURTH ANNUAL CONFERENCE ON

TAXATION

UNDER THE AUSPICES OF THE

National Tax Association

HELD AT ST. PAUL, MINNESOTA
OCTOBER 13–16, 1941

AND

MINUTES OF THE ANNUAL MEETING OF THE MEMBERS
OF THE NATIONAL TAX ASSOCIATION
HELD OCTOBER 16, 1941

EDITED BY

RAYMOND E. MANNING

Secretary

WASHINGTON D. C.
NATIONAL TAX ASSOCIATION
1941

NATIONAL TAX ASSOCIATION

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1941–1942

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ALBERT K. EATON
Department of Finance, Dominion Government, Ottawa

STUART GARSON
Treasurer, Province of Manitoba

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CERTIFICATE OF INCORPORATION OF NATIONAL TAX ASSOCIATION

No. 20264

This is to certify that we, the undersigned, all being persons of full age and citizens of the United States and the majority being citizens of the District of Columbia, desiring to associate ourselves for scientific and educational purposes and to that end, to form a body politic and corporate, under the provisions of sub-chapter three of Chapter Eighteen of the Code of Law for the District of Columbia, approved March 3, 1901, and Acts of Congress amendatory thereto, do hereby make, sign and acknowledge this certificate in writing, stating as follows:

First: The name or title by which the association or corporation shall be known in law is NATIONAL TAX ASSOCIATION.

Second: The term for which the corporation is organized is perpetual.

Third: The particular business and objects of the corporation are as follows:

To educate and benefit its members and all others who may be interested in the subject of taxation and the subject of public finance, of which taxation forms a part, by promoting the scientific study thereof generally, by the encouragement of research, by collecting, preserving, and diffusing scientific information and knowledge relating thereto, by organizing conferences and bringing together for discussion public officials, taxpayers and their representatives, students, instructors in universities and colleges and others interested in the subjects of taxation and public finance, by publishing and distributing reports of conference proceedings and such other books, periodicals and publications as may be desirable and helpful for the accomplishment of the purposes of the corporation; by appointing committees for the investigation of problems in taxation and public finance; by formulating and announcing, through the deliberately expressed opinion of its conferences, the best informed economic thought and ripest administrative experience available for the guidance of public opinion, legislation, and administration, on questions relating to taxation and public finance; by acquiring, utilizing, applying, and disposing of property and funds exclusively in establishing, maintaining, improving, and extending the benefits and usefulness of the corporation, through the accomplishment of its

purposes, and by promoting better understanding of the common interests of national, state and local governments in the United States and elsewhere, in matters of taxation and public finance and interstate and international comity in taxation.

The promotion of the above declared business and objects shall at all times be carried on subject to the following conditions and limitations, by which the corporation and all who shall hereafter associate themselves with it, as members, as participants in its deliberations and activities and in its conferences or otherwise, shall be forever bound; that is to say:

The activities of the corporation shall be non-political and non-sectarian.

No part of the net income of the corporation shall at any time inure to the benefit of any officer or member of the corporation or of any individual or corporation whatsoever. *In the event of the dissolution of the corporation or the discontinuance of its activities, its property and assets shall be donated to one or more such organizations or institutions as in the judgment of the executive committee or other managing body then in office will best use such property in the promotion of the aims and purposes expressed in this certificate.**

At any conference which the corporation may organize, members of the corporation shall not be entitled to vote, by reason of such membership, on any matter involving the official expression of the opinion of the conference on a question of taxation or public finance of general public interest, but the voting on such questions shall be vested in such persons in attendance as may be determined by the corporation and be expressed in such manner as may be prescribed by the conference when assembled.

At any such conference, the persons attending shall, by such attendance, be deemed to consent to the condition and limitation that the result of a vote upon a matter involving the official expression of the opinion of the conference on a question of taxation or public finance of general public interest shall not be announced or be given publicity in any report thereof issued by the corporation or be taken as having its endorsement, unless there shall have been full discussion thereof, at that or a prior conference and unless the vote shall represent the substantially unanimous opinion of the conference, which shall be deemed to be expressed by not less than a four-fifths vote.

* After having received the approval of the executive committee and the members of the Association, see *Proceedings*, Vol. 30, pages 542-545, the Certificate of Incorporation of the National Tax Association was amended by Certificate of Amendment filed in the office of the Recorder of Deeds of the District of Columbia on August 11, 1938. The amendment is printed in italics.

Fourth: The number of the managers of the corporation, who shall be called the executive committee, shall for the first year of its existence, be sixteen.

Witness our hands this 6th day of January, A. D. 1930.

(S) THOMAS WALKER PAGE
(S) JOHN E. WALKER
(S) WILLIAM P. RICHARDS
(S) ROBERT J. EBY
(S) ALFRED E. HOLCOMB

DISTRICT OF COLUMBIA, SS:

I, Walter F. Studdiford, a Notary Public in and for the District of Columbia, do hereby certify that Thomas Walker Page, John E. Walker, William P. Richards, Robert J. Eby and Alfred E. Holcomb, parties to the annexed and forgoing certificate of incorporation, bearing date the 6th day of January, 1930, personally appeared before me in said District the said Thomas Walker Page, John E. Walker, William P. Richards, Robert J. Eby and Alfred E. Holcomb, being personally well known to me to be the persons who executed the said certificate of incorporation and severally acknowledged the same to be their act and deed.

Given under my hand and notarial seal this 6th day of January, A. D. 1930.

(S) WALTER F. STUDDIFORD,
(NOTARIAL SEAL) *Notary Public, D. C.*

OFFICE OF THE RECORDER OF DEEDS
DISTRICT OF COLUMBIA

THIS IS TO CERTIFY that the foregoing is a true and verified copy of the Certificate of Incorporation of the *National Tax Association* and of the whole of said Certificate of Incorporation, as filed in this Office this 6th day of January, A. D. 1930.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of this Office this 6th day of January, A. D. 1930.

ARTHUR G. FROE,
(SEAL) *Recorder of Deeds, D. C.*

BY-LAWS OF THE NATIONAL TAX ASSOCIATION

(As adopted Jan. 6, 1930 and amended Oct. 1, 1936, Oct. 28, 1937 and Sept. 12, 1940)

ARTICLE I

Membership

Section 1. Any person shall be eligible to membership and may become a member, upon application in writing and payment of annual dues for the current year. Such application shall indicate sympathy with the objects and purposes of the association, as expressed in its certificate of incorporation and willingness to be bound by the conditions and limitations contained therein and in these by-laws, *Provided* that the present members of the National Tax Association, an unincorporated association, shall be members, without further action on their part.

Section 2. Membership shall be continuing. The annual membership dues shall be five dollars, payable upon application for membership, covering the fiscal year of the association then current and annually thereafter, in advance, on the first day of the subsequent fiscal year.

In the discretion of the executive committee, the annual dues may at any time be increased and the annual dues of residents of any foreign country may be fixed at an amount in excess of those of residents of the United States.

Any member who shall fail to pay his dues within six months from the date when payable shall be considered in arrears and if such failure shall continue for a period of one year, he shall be dropped from membership, for non-payment of dues.

ARTICLE II

Annual Conference

Section 1. An annual conference on taxation shall be held under the auspices of the association, at such time and place as the executive committee may determine. The annual conference shall be the means used by the association for carrying into practical effect its purpose to secure an expression of opinion that will formulate and announce the best informed economic thought and ripest administrative experience available for the correct guidance of public opinion and legislative and administrative action on all questions pertaining to taxation, and to interstate comity in taxation.

Section 2. The personnel of each annual conference shall be composed of delegates appointed by the governor or other chief executive of states, public officials having duties with respect to the investigation, enactment and administration of tax laws, instructors

and students in universities and colleges, taxpayers and their representatives, and others interested in the subjects of taxation and public finance.

SECTION 3. The voting power of the conference upon an official expression of its opinion is limited, with the purpose of safeguarding the conference from the possibility of having its expression of opinion influenced by any class interest, or consideration for those who devote their time to the work or management of the association, or favor for those who contribute money for its support.

The voting power in each conference upon any question involving an expression of the opinion of the conference on a question of taxation or public finance of general public interest shall be vested in the delegates in attendance appointed by the governor or other chief executive of states. In voting upon such questions each state shall have one vote, and in case of a division of opinion among the delegates therefrom, the vote shall be divided, so as to give proportional weight, by approximate fractions, to the opinions of the respective delegates.

If the result of such vote shall not reflect substantial unanimity on the subject in question, no publication thereof shall be made and it shall not be considered as expressive of the opinion of the conference. Such unanimity shall be deemed expressed by a four-fifths vote.

Voting by proxy shall not be allowed.

No member of this association shall have the right to vote in any annual conference solely by virtue of such membership.

SECTION 4. One session of each annual conference, or so much of it as may be necessary, shall be devoted to the consideration of the report of the conference committee on resolutions and conclusions. The report of this committee, as adopted by the conference, shall be its official expression of opinion, and it shall not be held to have endorsed any other expression of opinion, by whomsoever made.

No resolution approving or opposing legislation shall be considered by the conference unless it has been discussed at a session of the conference at which it is proposed, or has been the subject of a report made thereon by some committee of the conference or of the corporation, or has been the subject of a resolution adopted by some previous conference.

SECTION 5. The temporary and permanent chairman, secretary, official stenographer, address of welcome and response to the same, meeting place, accommodations for delegates, all necessary preliminary details for each conference, and the program of papers and discussions, shall be arranged for the conference by the executive committee of the association. All other details of the organization and conduct of the conference shall be arranged by the delegates present in such manner as they may from time to time decide.

ARTICLE III

Annual and Special Meetings of the Association

Section 1. The annual meeting of the association shall be held in connection with the annual conference, at such time as the executive committee may determine. Sixty days' notice shall be given to all members of the time and place at which such annual meeting is to be held, by publication in the official Bulletin of the association or by mailing such notice to each member.

Section 2. Special meetings of the association may be held at any time and place, when called by the executive committee. At least thirty days' notice shall be given to all members of each special meeting, by publication thereof in the official Bulletin of the association or by mailing such notice to each member, which notice shall specify the purpose for which the meeting is called, and no business shall be transacted at such meeting, other than that specified in the notice.

Section 3. A majority of all members present at any annual or special meeting of the association shall constitute a quorum for the transaction of business, but such quorum shall at no time be less than fifteen, and whenever the attendance of members exceeds one hundred, twenty-five shall constitute a quorum.

ARTICLE IV

Officers and Executive Committee

Section 1. The affairs of the association shall be administered by a president, a vice-president, a secretary, a treasurer and an executive committee, consisting of the above officers and the ex-presidents, who shall be members *ex-officio*, and nine elected members. The term "ex-presidents" as used in this section shall include the ex-presidents of the formerly existing unincorporated association, known as the National Tax Association, as well as the ex-presidents of this incorporated association. The officers shall be elected annually by the members and, with the exception of the president, shall be eligible to re-election. Their terms of office shall begin thirty days after the date of the meeting at which they are elected and they shall hold office until the terms of office of their successors begin.

The elected members of the executive committee shall be divided into three classes, of equal number, each class holding office for three years and until their successors have been elected, provided that at the first election held after the adoption of these by-laws, three classes shall be established, of three members each, to hold office for terms expiring at the time of the first annual meeting of the corporation for the election of officers and of the next two succeeding annual meetings respectively, and thereafter three members shall be elected at each annual election, for a term of three years, and

also such additional members, if any, as may be necessary to fill vacancies, to hold office during the remainder of the terms of the members whose places they fill. No member shall be eligible for re-election to the committee to succeed himself, but this provision shall not be applicable to *ex-officio* membership therein.

Two persons residing in the Dominion of Canada may be elected annually to serve as honorary members of the executive committee.

A vacancy in any office or in the membership of the executive committee may be filled by the executive committee for the unexpired term.

The executive committee may appoint such other officers and agents as it may deem appropriate to the purposes of the association, to serve during the pleasure of the committee.

ARTICLE V

Duties of Officers and Committees

Section 1. The executive committee shall manage the affairs of the association, subject to the provisions of the certificate of incorporation and of these by-laws. All appropriations of the funds of the association must be authorized or approved by the executive committee. Meetings of the executive committee shall be held at such times as the committee may determine. At such meetings ten members shall constitute a quorum. By order of the president, propositions may be submitted to the members of the executive committee, to be voted upon by mail ballot, with the same force and effect as if voted upon in meetings of the committee.

The executive committee shall have power to appoint standing or special committees and prescribe their duties.

The executive committee shall have full power and authority, in the interval between meetings of the association, to do all acts and perform all functions which the association itself might do or perform, except that it shall not have power to amend the certificate of incorporation or the by-laws.

The executive committee may authorize the president, or in his absence or inability to act, the vice-president, the secretary and the treasurer to exercise all the powers and functions of the committee, with respect to matters and things arising in the routine management of the association, requiring the formal action of the officers, during the intervals between the meetings of the committee.

Section 2. The president shall be the chief executive officer of the association and shall preside at the meetings of the association and of the executive committee, and shall perform such other duties as the executive committee shall prescribe.

In case of the absence or inability of the president, the duties of the office shall be performed by the vice-president, and in his absence, by such member of the executive committee as that committee may designate for the purpose.

SECTION 3. The secretary shall keep a record of the proceedings of all meetings of the association and of all other matters of which a record shall be ordered by the association.

He shall issue notices of all meetings of the association and shall perform such other duties as may from time to time be assigned him by the association or the executive committee.

SECTION 4. The treasurer shall keep a complete roll of the members. He shall have the care and custody of all funds and property of the association and shall deposit the funds of the association in such banks or depositories as the executive committee shall designate. He shall, under the direction of the executive committee, disburse all moneys and sign all checks and orders for the payment of money. He shall, when authorized by the executive committee, execute the papers necessary for the transfer of any property or securities of the association. He shall perform all the acts incident to the position of treasurer and may, in the discretion of the executive committee, be required to give an appropriate bond, at the expense of the association.

His accounts shall be audited by a committee of the association or otherwise, as the association may prescribe, and he shall at the annual meeting make report of the financial transactions of the association for the past year.

ARTICLE VI

PROCEEDINGS AND PUBLICATIONS

SECTION 1. The association shall provide for the publication and distribution of the proceedings of the annual conference.

SECTION 2. The executive committee shall authorize the terms of sale or distribution of all publications issued by the association.

ARTICLE VII

CONSTRUCTION

The word "state" whenever used in these by-laws shall be deemed to comprise state, territory, the District of Columbia, an insular or other possession of the United States or a place over which the United States exercises extra-territorial jurisdiction, and a Canadian province.

ARTICLE VIII

AMENDMENTS

SECTION 1. These by-laws may be amended at any annual or special meeting of the association by a two-thirds vote of all members present; provided, the full text of the proposed amendment shall have been submitted to the members, either by publication in the BULLETIN of the association or by mailing the same to each member at least thirty days prior to the meeting.

FIRST SESSION

Monday, October 13, 1941, 10:00 A. M.

Ballroom, Lowry Hotel

President Allen J. Maxwell, presiding.

President Maxwell: Ladies and Gentlemen, under the rules of the National Tax Association it is my responsibility and honor and privilege to call to order the Thirty-Fourth Annual Conference of the National Tax Association.

It is perhaps excusable that we are a little late in beginning our session this morning, according to the program, because of the rush at the registration desk. I hope that one feature of this conference will be promptness in beginning and attending its sessions. We have a program that will tax our resources to complete, and I hope that all delegates and members will bear that in mind and try to meet promptly according to the time assigned on the program.

The National Tax Association is a rather peculiar organization in one respect. It has a very broad membership that it has maintained over this period of 34 years, and it meets about 15 minutes once a year. It sponsors an annual conference, which is not an official meeting of the National Tax Association itself but is composed of delegates appointed by the governors of the various states. They are the ones who have the voting privileges in these conferences. Of course, the conference is open to members and friends of the National Tax Association for privileges other than that of voting.

I believe it is provided in the by-laws of the National Tax Association that the president and secretary of the National Tax Association may act as the president and secretary of the conference. I am a little in doubt as to whether that should be confirmed by motion and action of the conference or not.

Henry F. Long (Massachusetts): Mr. President, in order that there may be no misunderstanding and in order that we can show our appreciation of the presiding officer and of the president of the National Tax Association, I nominate as the chairman of this conference Allen J. Maxwell of North Carolina, and in order to save the president of the National Tax Association any embarrassment, despite the fact that he probably could with great calmness exercise the dual capacity, I ask all those in favor of Mr. Maxwell being the permanent chairman of this conference to signify by saying, "Aye."

(Ayes.)

MR. LONG: Contrary-minded.

(None.)

MR. LONG: Mr. Maxwell, you are unanimously selected—and it is a mark of deep respect and admiration—as chairman of this conference.

PRESIDENT MAXWELL: I thank you, Mr. Long.

The next order of business would be the adoption of rules of procedure.

MR. LONG: Mr. President, in order to keep the record clear, wouldn't it be advisable, if you will permit it, for me to move that Mr. Raymond E. Manning of Washington, D. C. be the secretary of this conference?

PRESIDENT MAXWELL: That is quite right.

PHILIP ZOERCHER (Indiana): I second the motion.

MR. LONG: I may say in passing, because I should give Mr. Manning a bit of a eulogy, that as secretary of the National Tax Association he has proven what we have come to think of him in the conferences that he has attended as being one very conscious of our every desire and has also departed — but not radically — from previous practices, particularly in the program.

Someone has suggested—and this is no reflection on the previous programs—that they look too much like a railroad timetable. I suggest that Mr. Manning be given a vote of confidence for this departure, and I move that he be selected as the secretary of this conference.

PRESIDENT MAXWELL: The chair is very happy to put the motion to elect Mr. Manning as secretary of the conference. All in favor of that please say, "Aye."

(Ayes.)

PRESIDENT MAXWELL: He is unanimously elected.

The chair will now recognize Senator Orr for a motion with respect to the rules of the conference.

CHARLES N. ORR (Minnesota): Mr. President and Members of the Conference: If you find these rules difficult to listen to, remember that I not only have to listen to them but I have to read them.

RULES OF PROCEDURE

General. The provisions of the Certificate of Incorporation and By-Laws of the National Tax Association shall govern the conduct of this conference generally, and these rules of procedure shall be

considered supplemental to, and subject to interpretation by such provisions.

Discussion. The usual rules of parliamentary procedure shall control. Each speaker shall be limited to twenty minutes for the presentation of a formal paper. He shall be warned two minutes before the expiration of such period. The time of such speaker may be extended by unanimous consent of those present.

In general discussion, each speaker shall be limited to seven minutes, and such time shall not be extended. No person shall speak more than once during the same period of discussion until others desiring to speak have been given opportunity to do so.

Voting Power. The voting power in this conference upon any question involving an expression of the opinion of the conference upon a question of taxation or public finance, of general public interest shall be vested in the delegates in attendance appointed by the Governor or other chief executive of a state. In voting upon such questions, each state shall have one vote, and in case of a division among the delegates therefrom, their votes shall be divided, so as to give proportional weight, by approximate fractions, to the opinions of the respective delegates.

If the result of such vote shall not reflect substantial unanimity on the subject in question, no publication thereof shall be made and it shall not be considered expressive of the opinion of the conference. Such unanimity shall be deemed expressed by a four-fifths vote.

Voting by proxy shall not be allowed.

On all questions other than those involving an official expression of the opinion of the conference, the voting shall be by all in attendance.

Committees. The receipt of reports made to this conference by committees of the National Tax Association shall not be considered as expressing the opinion of the conference on the subject treated.

The following committees shall be appointed:

(a) A committee of three on credentials, to be appointed by the chairman, who shall designate the chairman of such committee.

(b) A committee on resolutions, composed of one person from each state, to be appointed by the chairman of the conference, who shall also designate the chairman of such committee.

Resolutions. All resolutions involving an expression of the conference shall be read to the conference before submission to the committee, and shall be immediately referred, without debate.

No resolution approving or opposing legislation shall be considered by the conference unless it has been discussed at a session of the conference at which it is proposed, or has been the subject of a report made thereon by some committee or of the corporation, or

has been the subject of a resolution adopted by some previous conference.

Definitions. The word state as used in these rules shall comprise state, territory, the District of Columbia, and insular or other possessions of the United States or a place over which the United States exercises extra-territorial jurisdiction, and a Canadian province.

Mr. President, these being substantially the rules that have governed conferences through many years, I move their adoption as the permanent rules governing the Thirty-Fourth Annual Conference.

FRANKLIN S. EDMONDS (Pennsylvania): I second the motion.

PRESIDENT MAXWELL: All in favor of that motion will please signify by saying, "Aye."

(Ayes.)

PRESIDENT MAXWELL: It is so ordered.

I notice in the proceedings of the last conference President Gerstenberg very appropriately read the brief statement from the by-laws of the National Tax Association of the purposes of its annual conferences, which I will read as follows: "To formulate and announce the best informed economic thought and ripest administrative experience available for the correct guidance of public opinion and legislative and administrative action on all questions pertaining to taxation and to interstate comity in taxation."

I believe the conference is now properly organized to proceed with its program for the morning session. The conference is fortunate in having Mr. Daniel Hoan, Chief of the Field Organization of the Office of Civilian Defense in Washington, who has very kindly come here to discuss with the conference the question of "State and Local Fiscal Problems Raised by the National Defense Program."

Mr. Hoan is in a hurry to get back to Washington, and I will vary the program a little by presenting him as the first speaker on our program this morning.

DANIEL HOAN: Mr. President and Members of this Tax Association: To make certain that there will be no misinterpretation, I have submitted a paper, as have all the speakers, I hope, and I am obliged to read it, a task I am not capable of doing, as ordinarily I speak without a paper.

STATE AND LOCAL FISCAL PROBLEMS RAISED BY THE NATIONAL DEFENSE PROGRAM

DANIEL W. HOAN
Office of Civilian Defense

You are interested in learning how this defense program will affect the finances of state and local governments. Let me call your attention to the fact that no final or direct answer to this question can be given, for the reason, among others, that the problem involves federal-state-local financial relations which may shift markedly and in any of several directions. What will be the total expenditures? Are we ultimately to be drawn into war? What will be the extent of each locality's involvement? How much of their defense burden may the states ask the localities to assume? It might happen that the state would be inclined to provide a new means of revenue by which the locality could pay the entire cost. All such questions must be answered before we can render final exactions and effects.

Statistics on our governmental expenditures are not as complete as one would like, though a few major facts are clear. The largest single item of state and local expense is education; outlays for highways and streets come next; and public welfare, social security, and relief expenses rank third. Some generalizations about these services may prove useful here.

In a country that is planning to defend freedom of speech and thought the educational program is, and should be, one of the last to be curtailed. Perhaps at no time in our history has the value of our investment in free and universal education been so challengingly recognized. With the inequalities and the inadequacies that we know still exist in our school system we can ill afford to cut our educational budgets, though the defense program might well stimulate more careful planning in school expenditures with a view to getting the best returns on the money available. Certainly the increased demand for skilled workers in defense industries will call for increased expenditures on vocational training, particularly in those localities where the industries in question are located.

It is of some interest in this connection to note that recently the *United States Municipal News* printed part of a letter from the Board of Education of Buffalo to the Mayor where, in regard to the educational program required by national defense activities in that city, it was said:

> "Federal appropriations for vocational training of defense workers are not adequate to do the whole job. And cities are faced with the task of supplementing Federal appropriations. In this particular case, Buffalo is asked to appropriate $100,000 for vocational training purposes.

As has been repeatedly pointed out in the submission of annual budgets for the past several years, absolute minimum items have been submitted each year for replacements and for supplementary vocational equipment in the interest of economy. As a result, much vocational equipment has become obsolete and most of the remainder, through long, continued use, has been rendered unfit for 24-hour daily operation."

Obviously, no comprehensive program of civil defense would be complete without a trained and well-organized corps of auxiliary firemen and policemen. Even though the federal government may pay the lion's share of operating all training schools, there will be traveling expenses as well as the equipment needed to conduct such schools at central points.

It is of interest at this point to note that Mayor LaGuardia, Director of the Office of Civilian Defense, has forwarded to be introduced in Congress a bill which he described in a letter to the President of the Senate dated September 23, 1941, as follows:

"The purpose of the proposed legislation is to best authority in the Director of Civilian Defense, appointed under the authority of Executive Order No. 8757 of May 20, 1941, to provide adequate protection to persons and property in such localities in the United States, its territories and possessions as may be susceptible to bombing attacks.

The facilities, supplies, and services required to furnish such protection consist of fire-fighting facilities, such as auxiliary equipment, to meet the great fire hazard of bombing attacks; medical supplies and equipment for first aid, and medical units for the care of civilian casualties; protective clothing and distinctive insignia to insure protection and identity of volunteer operators; schools for the training of civilian instructors; gas masks for volunteer operators, and the procurement of a sufficient quantity of such masks so as to create facilities which will insure prompt production of ample quantities of gas masks for protection of our civilian population in the event of need. The necessity for the taking of such steps as soon as possible is apparent. There are many cities and areas within the United States, its territories and possessions which are particularly susceptible to such bombing attacks, and which are unable by their own means to provide against the effects of such bombing.

This legislation authorizes the loan of such facilities and supplies to civil authorities; it also authorizes the transfer of equipment and supplies not needed by other departments and agencies of the Federal Government to the Director of Civilian Defense for such use."

It is evident that the policy recommended by Mayor LaGuardia, if adopted by the Congress, may have a very profound effect. We know to what great extent Congress has already gone in providing funds for the training of auxiliary forces needed in a time of emergency and for the financing of equipment for the state guards which take the place of the National Guard. We know of the increased federal interest in health programs and social security. We realize that within the past few years there has been a virtual revolution in the part played by the federal government in a financial way in scores of activities formerly regarded strictly as local, or in services which were not performed at all by governmental agencies. But Congress has not yet indulged in any considerable spending to purchase facilities or to conduct services that may arise from a national emergency, if not war itself.

Turning now to state and local expenditures for highways and streets, they are not likely to be curtailed in any significant manner. Economies which might and should be made by delaying certain customary improvements and expansions will in all probability be far outbalanced by the expenditures involved in building up certain of our highways for possible military use. The states could effect considerable reductions in maintenance costs by limiting the load of the heavy trucks that travel the ordinary highways. Such action, incidentally, might lessen the amount of money needed by the states for highways so that municipalities might look forward to some relief with respect to financing street construction. Personally, I think that since the people of this nation paid for the building of the railroads, and since it seems to me they are the proper vehicles for the transportation of heavy freight, the taxpayers other than those who pay the motor vehicle taxes ought not to be called upon to pay for the building of roads sufficiently strong to support competitive truck freight trains. The federal government should supply all revenues for paving costs due to any military operation.

The third major item of state and local expenditure, public welfare and relief, might well be expected to continue to shrink as we intensify defense efforts. Defense industry expansion, together with its increase in pay checks, will stimulate employment in other lines of industry as well. The Selective Service program will create vacancies for employables and also will no doubt directly lighten the relief rolls. The Office of Production Management and other national defense agencies are encouraging the development of defense industries in localities with labor surpluses. Many communities are already benefiting greatly from these efforts. All local authorities must be on the alert to take advantage of every possible shrinkage in relief requirements. General reductions in public welfare funds, however, will of course have to depend on the actual lightening of the rolls, and state and local governments would be well advised to guard against the tendency to cut administrative and

investigatory expenditures before a downward trend in the relief rolls themselves has been established. In some cases, in fact, cuts in the welfare and relief budgets may not be justified. Responsibility for the dependent, the aged, and the unemployed will continue through the period of preparedness.

Among other things that the current war is showing us is the important rôle that local police, firemen, and home guards play in the internal defense of a country. At the same time, the secret maneuverings of foreign agents have led the FBI to look for increased assistance and cooperation from local police forces. Here again, much as in the case of highway and street departments, certain reductions in the budgets of the protective services might wisely be made, but some additional expenditures will have to be anticipated to meet the higher minimum of equipment and training that internal defense requires under present-day conditions.

Civil fire defense, in particular, has assumed more and more importance. New methods have moved the battle lines into the midst of the cities. The conflict is no longer merely one of trench warfare. We face the job of planning what to do if, say, 50 fires are started at one time. We have the benefit of London's experiences in identifying the problems and dealing with them. We know, for example, that ten auxiliary firemen are needed in Great Britain to every one that existed before. It is obvious that the auxiliary fire defense will be just as important to the protection of our cities as any branch of the military service. I am glad an increasing number of local officials are taking the same view. Now training schools must be expanded, for we must train these auxiliary firemen. It is said that an economical way to do it has been found in Boston. The officials of that city called upon the American Legion to furnish men above 35 years of age for night fire-fighting training without salary. Veterans and other groups are more than willing to help supply people for such civilian defense activities. New York City and many other areas have developed extensive plans for fire defense, also. In addition to training, there is the problem of equipment. I don't want to undertake to predict what Congress may do about the financing of this matter, but I believe we must look forward to the states sharing some of the cost.

Surely we can look forward also to much more voluntary help. As chairman of a local defense council during the first World War, I never had anybody refuse to furnish voluntary service. In time of crisis people are waiting to be called. We have believed in the national office in Washington that, before issuing calls for such service, proposed programs should be properly thought through. It is well to proceed with reasonable care so that there can be some assurance that the results of a task undertaken will be lasting and beneficial.

Inasmuch as the world, not exclusive of the United States, is passing through a war in which totalitarian government versus democracy seems to be the issue, and since the world is also passing through one of those great periods of economic, social, and political upheaval that will compel us to change our thinking to meet changing conditions and to adopt new concepts to answer the problems of a new day, it is time to begin looking for the solution of some of our governmental financial difficulties in new directions.

The fact is, that for several years the most vexatious of all municipal and state problems has been that of finance. There has been constant pressure from taxpayers' groups and others who have felt that the real solution of our headaches lies in spending less and less public moneys. We are compelled to admit that the theory that the best government is that which governs least, and spends the least, has by sheer necessity been thrown into the discard. This applies not only to the federal government but to state and local governments as well.

As perhaps one of the first steps in revising our thinking, let us take up the question of the handling of crime. The most conservative authorities estimate the annual cost of crime to the nation as being 15 billion dollars. This means an expenditure, or perhaps better said, loss per capita of over $113. If by one means or another this sum of money could be saved each year, in three years, or surely in four years, we would have accumulated an amount which would be equal, if not greater than the total expenditures for national defense.

I know a city that has succeeded in saving four-fifths of that bill in its community. What does this mean? The city in question has a population of approximately 600,000. The total loss either to its citizens or to the citizens that transact business or visit the community would amount to 600,000 times the average per capita loss, or 67 million dollars. If the city has reduced its crime by four-fifths, it is actually saving its citizens over 54 million dollars. In this particular city the annual municipal budget of expenditures for all purposes is approximately 30 million dollars. Did this city effectuate this saving in its crime bill of almost two dollars for every dollar spent for municipal purposes by pinching public expenditures or by cutting the tax rate drastically? Indeed not. It went ahead to provide a comprehensive system of well-distributed, well-managed playgrounds throughout the entire community. It opened up its school houses for the most widespread program of social center activities, both of a recreational and educational character, that is known anywhere in the country. It made provision in the tax budget for the most extensive all-year program of indoor and outdoor athletics for both minors and adults known in any community. It had perhaps the most extensive and thoroughly comprehensive educational program facilities available anywhere. In short, oppor-

tunities were offered to make it possible for every individual, employed or unemployed, child or adult, to connect himself with either organized recreation or education. Did this cut down the amount of money needed to support a motorized police department? It did not. It has a record of having the most efficient police department of any city in the country. The fact that it only has one-fourth the average crime of the 35 largest cities in the country should be proof of this. Did the city skimp in the budget for its fire department? It did not. That city enjoyed the lowest insurance rates of any city in the country. Did it attempt to slaughter the public health program? It did not. It took either first or third place in all the national contests in which it was permitted to participate. When it did not participate it was placed on the honor roll.

What happened to the tax rate in that city? Did it soar away above the average for American cities? It did not. In this particular community, the citizens started out wholeheartedly to do justice to its children and to attempt to solve its crime problem in a wholesome manner. They discovered that by making expenditures in one direction, they were saved in others. They found that by comparing their own budget in that respect with those of other cities that they were spending only one-eighth as much for policemen and courts as some of the other well-known cities, and that these savings financed the extension of playground and other recreational facilities. In brief, by actual experiment it has been shown that economy in municipal government means generous spending in several directions in order to accomplish sound economy in others. Economy is not only in finance but in the building of human character, of having due regard for the health of the citizenry in addition to the proper cultivation of their minds.

Time prevents a discussion of a number of other examples to indicate that a lot of theories which have governed us in the past are now found to be unworkable and must be thrown into the discard. The world is changing. The oxcart has changed into the transcontinental highway and the clipper plane. We have jumped from a period of famine and hunger to one of over-production, under-consumption, surpluses, and whatnot. We have reached the stage when there is plenty of everything, but 99 percent of the people do not believe it. In fact, they refuse to believe it.

There was a time when there was some justification for cutting each other's throats in what we call war because there was a deficiency of this, that, or the other thing and some greedy neighbor sought to steal the goods of his neighbor while always proclaiming loudly that God was on his side. But we are now in a new world of plenty, and we must plan accordingly. It is more important to find ways and means so that everybody may work and produce rather than to sit around and figure out how we can reduce our budgets to the starvation point. If this world war compels us to

forget a lot of old, time-worn, hackneyed, unworkable theories of the past and compels us not only to think out but to put into practice proposals that will bring to humanity in general the greatest possible blessings from scientific and industrial progress; if we can learn to stop killing one another long enough to set the machinery of the world producing not only the necessities of life but some of the luxuries as well, our problem would change from having the jitters because of so much poverty to one of great concern as to how we can sensibly conduct our system of government in a world of peace and plenty.

Both Mayor LaGuardia and President Roosevelt have repeatedly called attention to the need of studying seriously and making plans now for the furnishing of employment to the millions that are bound to be thrown out of work at the conclusion of the war. I should like to quote from a press release on this subject that has just come to my attention:

> "What's going to happen to America's skilled and unskilled workers now engaged in boom defense work when and if the war ends?
>
> The administration's answer to this problem is being worked out these days over at the Federal Works Agency—and it looks like a 25-to-30-billion dollar answer. Organization of what some day may be the largest public works program in the history of the world has been going on rapidly since June 23 when what is officially known as the Public Works Reserve was created.
>
> Heading up the gigantic planning program—which may be tossed to Congress suddenly if Hitler cracks unexpectedly—is Jacob Baker, former president of the United Federal Workers of America. Baker has been given the title of Coordinator of the Reserves, which has the job of finding what public work projects can be listed and held in abeyance for the day when war activities cease.
>
> President Roosevelt has placed his seal of approval upon the gigantic planning program with these words: 'I know that you will realize that when this national emergency is over it will be necessary to find work for a great many of our citizens and we, therefore, are building up a backlog of highly desirable public works to be put into effect when that time comes.'"

The fact is that economists everywhere, both inside and outside of government, are beginning to be seriously concerned with such problems, and because of this we may look forward with more hopefulness to meeting future crises with at least some measure of preparedness, rather than to pursue the old policy of continuing to drift along in a haphazard manner, hoping that prosperity, like the end of the rainbow, lies just beyond or around the corner.

President Maxwell: I am sure the conference is indebted to Mr. Hoan for coming here and bringing us this informative message.

One of the important features of every conference of the Tax Association is that of announcements, and I am sure the conference will be interested in the announcements of Senator Orr, chairman of the local Committee on Entertainment.

Senator Orr: Mr. President and Members of the Conference: May I assure those speakers who are to follow me that I haven't any purpose to take a moment of their time in the discussion of trite and abstract themes. "You are very welcome in our house. It must appear in other ways than words." So said a traveling bard many centuries ago. This is not a welcoming speech—not that you are not going to be efficiently welcomed at the noon luncheon today when we will put on a couple of epigrammatists and word colorists who will ravish your delighted ears with their succulent seductiveness.

This is a work conference. It probably does more work and keeps harder at it than any convention I think I know anything about. For that reason there is little entertainment for the men. There is only one, concerning which I will speak to you about in just a moment.

The committee has prepared, I think, a delightful program for the ladies, and it is all contained in the little program which you can obtain at the ladies' headquarters in the Silver Room on the other side of the hotel.

As you note by the program, the second day of the conference is held at the University of Minnesota; that is, the morning and afternoon conferences. The evening conference will be held in this hotel. In order to get you over to the university it is necessary that we proceed on time. The conference starts over at the university at nine-thirty. There will be a series of buses out in front of the hotel and the last one will leave at nine o'clock.

On the question of tickets: There is a luncheon this noon that you ought to attend, because the mayor will be there. He will tell you of the beauties of the city and a lot of other things you possibly ought to know about. Also, the university would like to know—and the tickets are on sale out at the registration desk—how many are going to be present at the luncheon over there, so that they can properly prepare for it.

I come now to the only entertainment for the men, and it includes the women, too, and that is the official program for Wednesday evening, the official banquet of this conference. The only speakers will be the president of this organization—and certainly you want to compliment him by being present—and the governor of the state of Minnesota, who will speak to you upon an important subject.

The tickets for this banquet are $2, as they have been through all the conferences that I have attended for years. May I suggest to

you respectfully that the price you pay for your ticket is just a very inconsiderable part of the cost that that ticket represents. It is not only a banquet, but it is a delightful ice show, and the tables will be arranged around the ice in the auditorium.

It begins at six o'clock with a cocktail party and the accouterments that go with such a party. That will begin at six o'clock and it will close at six forty-five. I repeat, it will close at six forty-five.

After the cocktail party you are expected in that 15 minutes to be in your seats around the ice by seven o'clock. It is necessary that we proceed on time. We don't want any abridgment of these splendid speeches, and yet, the people putting on this ice show, some of them, are young, and they have to be out of the auditorium by eleven o'clock. So that we are running on a time schedule.

May I simply suggest further that you will find many men around here wearing these white badges, "Reception Committee." Those are men of your own type. They are not dusky servitors or anything of that kind. They are men who have attended these conferences for years. They are your servants, however, and if you whisper in their ears something that you want, they will either supply it or they will get it up to my committee, and we hold ourselves in readiness to stop Hitler in 15 minutes if that is necessary to be done, or we are obliged to.

President Maxwell: Thank you, Senator Orr.

Discussion of the paper that Mr. Hoan presented will be deferred until the other two papers on the program this morning have been presented.

The next one that I will call for is Mr. Manning's paper which was first on the list. I think the reason Mr. Manning was elected secretary of this Association succeeding the very able and efficient Mr. Query was the fine way Mr. Manning had digested for these conferences for a number of years the state tax legislation for the previous years, which is always an interesting subject, keeping up with what other states are doing.

I am now happy to present Mr. Manning for his annual paper.

STATE TAX LEGISLATION, 1941

RAYMOND E. MANNING
Library of Congress

SUMMARY

The year is especially noteworthy for the amount of legislation directly traceable to our program of national defense. The states have sought to relieve men in the service from certain of the rigors of their tax laws, and some have specifically accepted the benefits of the Buck Resolution allowing taxation of activities in federal

areas. There is still much evidence reflected in the state laws of a continued pecking away at immunities claimed or recognized under the constitution.

On the whole, there has been little in the way of fundamental changes in the state tax systems. There have been some new important taxes added, and some increased rates applied; also, there have been some taxes repealed, and lower rates put into operation. Included in the new taxes are at least twelve on the use of gasoline, three on cigarettes, two on betting at horse races, two on gifts, two on the income of banks, one on chain stores, and one on oil production. Increased rates will be applied to general sales in one state, gasoline in three, and liquor in nine. Oleomargarine and poll taxes were abolished in one state each, and general sales taxes were reduced in two states.

Several other changes of importance follow. The exemption of intangibles of non-resident decedents from death taxes was decreed in four states, and provision was adopted, also in four states, for the compromise of death taxes, where the domicile of the decedent is in doubt. Authority to impose personal income taxes was the subject of proposed constitutional amendments in two states. The states were also concerned with determining who is a resident, and how should non-residents be taxed under the personal income tax laws. New allocation formulas for corporations doing business within and without a state were also adopted. In the field of property taxes, several additions were made to the exempt list; there was a noticeable reduction in the amount of concessions granted to delinquents. Tax studies were provided for in four states.

FEDERAL-STATE RELATIONS

The extent to which the present emergency has given rise to federal-state problems, or has prompted the states to become "generous" in their attitude towards persons in the military service, constitutes an interesting chapter in the history of intergovernmental relations. Many laws affecting general sales taxes, gasoline taxes, tobacco taxes, liquor taxes, personal income taxes, poll taxes, motor vehicle taxes, and property taxes, have given expression to the favor or disfavor with which the federal government is regarded. Each of these categories is discussed below.

The general sales tax laws were variously amended to reflect the disposition of the states toward the federal government. Jurisdiction over all federal areas for purposes of taxation (as granted by the Buck Resolution) was accepted by Oregon and Washington, and provision made for taxing sales to the United States and sales on military reservations and other federal areas. Oklahoma allows an exemption from sales and use taxes for cost-plus-a-fixed fee national defense contracts, while California (though permitting postponement of the tax awaiting final court decision), provided for taxing

sales to government contractors for improving real property. Indiana denied exemption from the gross receipts or gross income tax on account of activities performed in federal structures. Sales of surplus food procured through use of federal stamps were exempted by West Virginia, and New Mexico declared against taxing deposits of gold or silver with the United States.

Gasoline tax exemption, or refund for taxes, was allowed for fuel used under cost-plus-a-fixed fee contracts in Kansas and California, but the exemption in California will apply only until final judicial determination that such sales are taxable. Other exemptions include gasoline used by the federal government or any of its departments in performance of government functions or works in Oregon, gasoline used on national defense projects in Missouri, or in United States planes training cadets in Georgia and South Carolina.

Sales of cigarettes to or by post exchanges were exempted by New York, Pennsylvania, and Texas.

Liquor sales to or by military post organizations, etc. were exempted by New Jersey, New York, and Vermont. Pennsylvania amended its liquor act to permit clubs to waive, reduce, or pay dues chargeable to members in military service, and provided for refunds on malt beverage taxes exacted for sales to military posts. Florida exempted malt beverages not over 3.2 percent alcohol sold to post exchanges.

All the personal income tax states now provide for taxing the salaries of federal employees, Idaho, North Dakota, and Utah having completed the roster this year. Georgia has removed the exemption formerly accorded income from United States obligations. Oregon provided for taxing income arising within federal areas in Oregon. New York and Oklahoma deferred payments for persons in the military service. Iowa has added a provision whereby taxpayers receiving loans from the Commodity Credit Corporation may treat such loans as gross income. Wisconsin has adopted a special provision for taxing dividends received on stock in state building and loan associations so that stockholders therein will enjoy, so far as possible, the same advantages under the state income tax as are enjoyed by stockholders in federal building and loan associations under the federal income tax.

Corporate income tax laws were amended in several states to allow a deduction for amortization of war facilities. Maryland specifically applied its tax to corporations operating on property owned by the United States.

The polls of persons in the military forces were exempted by Maine, New Hampshire, and Vermont, while Rhode Island exempted all war veterans, and Texas exempted veterans of foreign wars whose disability is 40 percent or more.

Motor vehicle laws were amended in favor of the United States and persons in the military service. Some instances include the

granting of free plates for federal vehicles in Maine, and North Carolina waives certain license requirements for trucks on national defense projects or hauling T.V.A. or A.A.A. phosphate or agricultural lime. Motor vehicles of non-residents in the military forces stationed in Arkansas, Maryland, North Dakota, and Wyoming were made exempt from registration, while a refund was accorded by Minnesota, New Hampshire, and Wisconsin on number plates surrendered by persons in the military service. Connecticut exempted persons inducted into the military service from operators' permit requirements, and New York and Oklahoma extended the time in which operators could renew their permits after separation from the service.

Authority to accept payments in lieu of taxes on federal property was provided by Kansas, Michigan, Minnesota, Missouri, Oregon, and Washington.

Recognition of exemption was accorded by Indiana to lands ceded to the United States for post-offices, custom houses, etc., while California and Michigan cancelled taxes assessed against lands thereafter acquired by the United States. Florida specifically granted an exemption for certain property leased to the United States for national defense purposes.

Tightening up on exemptions was provided by New Mexico which deleted an exemption allowed property used in performance of a contract with the United States, by Oregon which applied its laws to certain property in federal areas, by Tennessee which provided for taxing certain land acquired in 1941 or 1942 on the 1940 assessed value and rate, and by Wisconsin which excluded from the exemption statutes residential, rental-income-producing, improved real estate acquired by the United States, a federal corporation or agency. Wyoming memorialized Congress to provide for making payments to counties for certain lands acquired for Indians.

Persons in the military service were granted certain special recognition by such laws as those of Iowa and Minnesota, which facilitated securing the homestead exemption, by Maryland and New York which postponed tax sales of their property, and by Michigan which exempted their homesteads while they are in the military service.

Special taxes on all property were authorized for Illinois cities, towns, etc. in or adjacent to federal defense projects, and Kansas counties adjoining military reservations. Oregon permitted delinquent property to be sold for national defense activities without the usual advertising.

The Federal Tax Lien Registration Act was adopted by Oregon.

ADMINISTRATION, ETC.

Noteworthy changes in administrative set-ups were effected in Colorado, Idaho, Indiana, and Michigan; the Michigan act also created a State Board of Tax Appeals. North Carolina segregated

the Statistical and Research Unit of the Department of Revenue, and established it as a separate Department of Tax Research. Special temporary tax studies were authorized by Indiana, Nebraska, Texas, and West Virginia.

Rules and regulations, their making, filing and publication, were outlined by California, Ohio, and Tennessee, while North Dakota established uniform rules of practice with right of appeal.

Reciprocal exchange of information with other states and the federal government was authorized in Pennsylvania.

GENERAL SALES AND USE TAXES

(See also above, under Federal-State Relations)

Extensive revisions of sales tax laws were adopted by Arkansas and Oklahoma, while laws scheduled to terminate in 1941 were continued by Colorado, Missouri, New York City, North Dakota, and Ohio.

Rates of tax were decreased from 3 percent to 2 percent in Illinois (except on gross receipts from utilities) and South Dakota, and from 1 percent to ½ of 1 percent for retailers in Indiana. Utah eliminated the $2 license fee. Miscellaneous increases were enacted in New Mexico, while Washington increased the 2 percent rate to 3 percent until enactment and judicial approval of a graduated personal income tax law.

Traded-in property will be specially treated in Colorado, Kansas and Michigan.

Exemptions have been increased, principally as follows. The restricted food exemption in North Carolina has been extended to all food and food products, while sales of bread, butter, eggs, flour and milk are to be tax-free in West Virginia, and Illinois has proposed a constitutional amendment to allow exemption of food sales. Washington eliminated the tax on distributions from a firm's central warehouse to its retail stores, and also accorded an exemption from the gross income tax to persons doing less than $600 worth of bimonthly business. Kansas has provided that taxes shall not be imposed on sales for use on public works, title to which will pass to the state or its local units. Other additions to the exempt list were made by Arkansas, Michigan, North Carolina, and Wyoming, while North Dakota repealed the $50 exemption from the use tax.

GASOLINE TAXES

(See also above, under Federal-State Relations)

The application of taxes to gasoline and other motor fuel has been variously affected. Definitions have been altered by Arizona, Connecticut, Idaho, Iowa, Kansas, Maine, Minnesota, Missouri, New Mexico, North Carolina, North Dakota, South Dakota, and Wyoming. Exemption has been accorded fuel used for transporting

school children in North Carolina and Oklahoma, while Oklahoma has also granted an exemption for fuel used by counties on highway and bridge work, Tennessee exempted carload purchases by local units and governmental bodies, and Wyoming exempted tractor fuel. Arizona has required that gasoline sold subject to refund must be colored.

Rate changes were made by Maine[1] from 4 to 4½ cents, by Minnesota from 3 to 4 cents,[2] and Oklahoma from 4 to 5½ cents. Temporary levies scheduled to expire were continued by Florida, Massachusetts, Nebraska, New York, North Dakota, Ohio, Pennsylvania, and West Virginia.

Use fuel taxes were adopted by Arizona, Arkansas, Kansas, Minnesota, Missouri, North Carolina, South Dakota, Tennessee, Texas, Utah, Washington, and Wyoming, all at the regular tax rate except Texas which doubled the existing 4-cent rate.

Other changes in gasoline tax laws include the following. The amount of gasoline that may be brought into a state tax-free was limited to 20 gallons by Idaho, New Mexico, and South Dakota. South Dakota, Tennessee, and Wisconsin have defined the point at which certain movements of gasoline will become taxable. The bonding provisions for dealers were altered by Tennessee and Wyoming. Iowa and West Virginia have proposed constitutional amendments, similar to those adopted last November by the electorates of Idaho, Nevada, and South Dakota, which limit the use of gasoline taxes to highway and related purposes.

ALCOHOLIC BEVERAGE TAXES

(See also above, under Federal-State Relations)

The rates of tax on liquors continue to rise, several substantial increases having been adopted in Florida, Georgia, Idaho, Illinois, Indiana, Maine, North Dakota, South Carolina, and Texas. Temporary increases were continued by Massachusetts, New York, and Pennsylvania. Other interesting changes were the imposition (in addition to other taxes) of a 20 percent tax based on the wholesale price of liquors, containing over 4 percent alcohol, sold by the Idaho Liquor Dispensary, and the repeal in Maine of the gallonage tax on wines and liquors sold by the state and the substitution of a consumers tax at a rate which will produce a tax of not less than 61 percent of the cost f.o.b. Augusta, Maine. Cider will be taxed 1½ cents per gallon in Connecticut. By a Delaware act, retaliatory rates will be imposed on liquors from other states which impose higher taxes on the Delaware product.

It is also noted that Tennessee repealed its 5 cents per pound tax on malt extracts.

[1] Change stayed by petition of referendum.

[2] The Minnesota tax was 4 cents until September 1, 1940, when the rate was reduced, under terms of the then existing law, to 3 cents.

TOBACCO TAXES

(See also above, under Federal-State Relations)

Three states have joined the list of those having cigarette taxes, namely Illinois, Maine, and Oregon. The rate in each case is 1 mill per cigarette, or 2 cents per package of 20. Of the states already having cigarette taxes, Oklahoma made the only important rate change in fixing the tax at 5 cents, instead of 3 cents, per package of 11 to 20, and 2½ cents, instead of 1½ cents, per package of 10 or less. Temporary taxes scheduled to expire were continued by Massachusetts, New York, Ohio, Pennsylvania, and Wisconsin.

Refund provisions for cigarette stamps not used have been added or liberalized by Connecticut, Rhode Island, and Texas.

Other tobacco products are made subject to a stamp tax in Oklahoma at the rate of $1 per 1,000 for little cigars, and $5 to $10 per 1,000 for regular cigars, and 20 percent of the factory list price for smoking and chewing tobacco. The Arkansas 10 percent tax on cigars was repealed.

MISCELLANEOUS EXCISE TAXES

New or revised acts taxing the sale of motor vehicles, or the use of vehicles purchased outside the state, were adopted by New Mexico, Oklahoma, and Texas. The rate is 1 percent in New Mexico and Texas, and 2 percent in Oklahoma. The 3 percent original registration fee in South Dakota was reduced to 2 percent in accord with the similar reduction in the rate of the general sales tax.

Amusements, including horse-racing, were the subject of several 1941 tax laws. In Maryland, for instance, the former 1 percent gross receipts tax on admissions was extended in its application, but the rate was reduced to ½ of 1 per cent, effective October 1, 1941. Florida and Illinois exacted additional taxes on horse-racing by imposing levies of 5 percent and 2 percent, respectively, on all sums wagered; Florida also takes 100 per cent of the breaks. In Delaware, the rate of tax was increased from 3 to 3½ percent. Pinball games, claw machines, and the like, were made subject in Washington to a 10 percent or 20 percent gross receipts tax, the higher rate applying if no element of skill is involved.

Agricultural products taxes were added to, or amended, in 1941, by several states. Among these are Arkansas and Texas, which joined with Louisiana (1940) in levying a tax of 2 cents per 100 pounds of milled rice, the proceeds thereof to be paid to the Rice Development Commission. Missouri added a 1 cent per bushel merchandising tax on apples. Occupation taxes, in lieu of property taxes, were imposed by Kansas and Minnesota on grain handling, the rate being ½ mill per bushel upon all grain received by dealers in Kansas, and ½ mill per bushel upon wheat, soybeans, and flax, and ¼ mill on all other grain in Minnesota. The oleomargarine tax

of New Mexico was repealed, while the Tennessee tax was limited to yellow oleomargarine or oleomargarine containing other than a specified list of oils and fats. A temporary excise tax of 1 cent per pound was imposed on all butter fat produced between June 1 and June 15 in Iowa.

POLL TAXES

(*See also above, under Federal-State Relations*)

All poll taxes in Florida were abolished by the 1941 Legislature. Miscellaneous amendments in Texas provide for payment by mail, and eliminate payment of the poll tax as a prerequisite for voting.

SEVERANCE TAXES

Among the oil production taxes of the year is a new 3 percent levy in Illinois, and an increase to 4⅛ percent (4⅛ cents per barrel if value under $1 per barrel) in Texas. Oklahoma continued its additional ⅛ cent per barrel levy.

Other mineral products taxed include the imposition by Minnesota on taconite of a tax of 5 cents per ton of merchantable iron ore concentrate, plus 1/10 cent per ton for each 1 percent that the iron content exceeds 55 percent. Minnesota also increased the occupation and royalty taxes on iron ore from 8 to 10½ percent for 1941 and 1942, and 9 percent thereafter; a credit equal to 10 percent of the cost of labor will be allowed persons engaged in producing low-grade ore. In Texas, the taxes on natural gas and sulphur have been raised to 5.2 percent and $1.272 per long ton, respectively, while carbon black will bear 122/1200 to 31/240 cent per pound, or 4.1 to 5.2 percent if the value exceeds 4 cents per pound.

Forest crops in Washington were classified by a 1941 act as personal property, and the tax thereon deferred. Beginning in 1942, in making up the assessment roll, 7½ percent of the tax will be deferred and an additional 7½ percent each year thereafter until at the expiration of 10 years 75 percent of the tax will be deferred, and so carried on the tax rolls; the deferred taxes will draw 3 percent interest.

DEATH AND GIFT TAXES

An estate tax replaced the old Arkansas inheritance tax, and a revised inheritance tax was adopted in Kansas. Colorado rewrote its 80 percent credit law.

The rates under the new Arkansas law will be ⅘ of 1 percent of the net estate between $10,000 and $100,000 and thereafter in an amount sufficient to take up the federal credit. The temporary increased rates of Massachusetts, New York, and Wisconsin were continued; a revised schedule of rates for taxing legacies and successions was also adopted by Massachusetts. In Colorado, the rate on Class A beneficiaries was increased by reducing the first two taxable brackets.

Deductions and exemptions received some attention. Kansas and Oklahoma made allowances for certain transfers already taxed within a 5-year period. Joint checking or savings accounts in building and loan associations were exempted by Connecticut. By a West Virginia act, widows are to have their $15,000 exemption and other Class 1 beneficiaries $5,000, irrespective of the size of their particular shares of the estate. Property passing to organizations of war veterans was exempted in Iowa.

The interstate problems incident to levy and enforcement of death taxes are illustrated by several 1941 laws. Four states, Minnesota, Missouri, North Carolina, and Ohio, provided for the exemption of transfers of intangibles by non-resident decedents. Colorado added a provision for reciprocal enforcement of death taxes on estates of non-residents, and Massachusetts provided for reciprocity concerning property received by tax-exempt institutions from non-resident decedents. The tax officials of Delaware, New Hampshire, New York, and Pennsylvania were authorized to compromise claims with respect to estates when the domicile of the decedent is in doubt. Georgia has made its estate tax applicable to non-residents in the ratio of the property in Georgia to the total property.

Gift tax laws were adopted by Oklahoma and Washington, and several amendments were made to the laws of California and Oregon. The emergency tax of Wisconsin was continued. The rates under the new laws of Oklahoma and Washington will range from 1 to 10 percent, and 0.9 to 22.5 percent, respectively. Colorado adopted a provision whereby non-residents desiring to establish a temporary residence therein may procure a non-resident certificate for $25 and thus be presumed not to be a Colorado resident for the purposes of the gift tax.

PERSONAL INCOME TAXES

(See also above, under Federal-State Relations)

Authority to impose graduated personal income taxes is contained in constitutional amendments proposed by Pennsylvania and Washington, and still awaiting ratification by the electorate.

The rate of tax has been changed in several states. In Maryland, the individual income tax rate is set at 5 percent on investment income and 2 percent on the balance, West Virginia has added three more $1,000 brackets to a former top of 4 percent on all over $3,000, so that hereafter there will be a 6 percent maximum on all over $6,000. South Dakota has lowered its rates to range from 1 percent to 6 percent, the maximum rate applying on taxable income exceeding $140,000. New York has dropped its emergency 1 percent tax, but Wisconsin extended its additional levies. California added a provision averaging out the tax in cases of persons receiving lump-sum payments of income covering 5 years or more.

Deductions and exemptions legislation was not especially important. A deduction for medical and burial expenses, etc. exceeding $100 was allowed by Idaho. In South Dakota, the deductions from tax allowed single persons, married persons, and dependents were raised to $8, 20, and $4, respectively. Iowa allowed a taxpayer to take a $5 tax credit for each dependent other than a minor child, or in certain cases a $300 income deduction. Provision for apportioning exemptions in case of a change of status was adopted by Montana. Less liberal regulations on deductions and exemptions are found in Georgia which denied a deduction for minors having an income exceeding $400 from a trust, in Vermont which denied the personal exemptions for income from intangibles when the entire net income therefrom exceeds $1,500 in the case of single persons or $3,000 for married persons, and in Wisconsin, which limited the deduction for federal income taxes to 3 percent of the net income.

Liability for taxes and determination of such matters as residence and apportioning income earned outside the state were defined by acts in 1941. Georgia applied its tax to persons domiciled therein on the last day of the year, and created a rebuttable presumption that a person spending six months of the taxable year in Georgia is a resident. And anyone in Georgia who changes his residence before the last day of the year shall be taxed for the proportionate part of the year. In North Carolina, the tax will be applied to persons resident in the state for six months, and to voters. North Carolina exempted the personal services of residents taxed elsewhere, and Idaho excluded the income of residents from out-of-state sources. Iowa varied the foregoing practices in excluding business profits derived and taxed in another state, or when such other state allows a similar exemption on profits made from business outside that state; salaries and other remuneration for personal or professional services are not deemed to be business profits. By a Minnesota law, non-residents deriving income from personal services in Minnesota, and returning home once a month shall be exempt from Minnesota tax, provided a similar credit is allowed Minnesota residents. Both Montana and Oregon made provision for allowing credits on a pro-rata basis for taxes paid by residents to other states. An interesting provision is found in a Colorado law which allows non-residents desiring to establish a temporary residence therein to secure a non-resident certificate for $25, upon the award of which they shall be presumed not to be residents of Colorado, and shall be exempt from the income tax on income derived from sources other than Colorado.

Miscellaneous other amendments to personal income tax laws include in gross income rentals or royalties from property in California, or for the privilege of using patents, copyrights, etc. in California, and authorize payment of taxes in four instalments in

Maryland and New York, three instalments if the tax exceeds $10 in West Virginia, and four instalments if the tax exceeds $30 in Washington.

CORPORATION INCOME TAXES

The Pennsylvania corporation income tax was continued for two more years, while temporary increased rates were continued or altered by Massachusetts and New York. Arkansas repealed the $1,500 exemption, and substituted a graduated 1 to 5 percent rate in lieu of a flat 2 percent.

Amended allocation formulas were adopted by Georgia, Oklahoma, and South Carolina. In North Carolina, a gross receipts allocation fraction will be used for corporations whose business is other than manufacturing or selling. Idaho added a provision specifically exempting income of domestic corporations from sources outside the state.

Credits and deductions came in for some consideration. In Idaho, for example, the allowed offset for license taxes payable by public works contractors and dealers in motor fuels was discontinued. A credit for a portion of the annual franchise tax will be allowed in Maryland. While Idaho allowed full deduction for federal income, excess profits, and capital stock taxes, Wisconsin limited the deduction for federal income, excess profits, and defense taxes to 10 percent of the net income. Excess profits taxes were made non-deductible by Maryland, while Arkansas repealed the allowed deduction for dividends received from other corporations. Maryland will allow deductions for gifts by corporations on the same basis as gifts by individuals.

Consolidated returns in Minnesota will be voluntary, instead of mandatory, in certain cases. A Georgia act required the Revenue Commissioner's consent before a consolidated return may be filed.

OTHER CORPORATION TAXES

Domestic and domesticated foreign corporations are to be taxed on the same basis in Georgia. Greatly amended franchise and license taxes were adopted by Maryland and Oklahoma. Other amendments were added by New York, North Carolina, and Texas.

BANK TAXES

Banks in Minnesota and North Dakota were made subject to taxes measured by their net income. The rates are 8 percent and 4 percent, respectively. Both taxes are in lieu of all others, except real property taxes. Banks were specifically exempted from the income tax law of Arkansas.

INSURANCE COMPANY TAXES

The insurance premium tax laws of Maryland and Nevada were rewritten, the rate of 2 percent generally to prevail, although in

Maryland the rate will be 1 percent on considerations for annuities and 1/15 of 1 percent of average deposits held by companies in connection with perpetual policies of fire insurance. The 2 percent Colorado tax law was amended to cover all policies or contracts of insurance on property or risks within the state. A 1½ percent premium tax also was adopted by Colorado for companies writing compensation insurance. A proposed constitutional amendment in California prescribes a gradually declining premium rate—2.35 percent by 1947—accompanied by a declining offset for real estate taxes. Rates in Texas on premiums of foreign companies have been increased to range from 3.1 to 4.65 percent in the case of life companies, and 0.75 to 4.05 percent for other companies; domestic companies of all types will pay ⅝ of 1 percent.

Foreign companies were subjected to special provisions in the laws of other states. For example, Arkansas required life, health, and accident companies to pay 2½ percent on their premium receipts, and Oklahoma jumped the rate on non-resident foreign insurers to 4 percent. Iowa eliminated the exemption allowed certain foreign companies; Maine provided that companies incorporated in foreign countries should be regarded as incorporated in the state of the United States in which they elected to make their deposit and establish their principal agency; New Hampshire repealed the 1 percent tax on the paid-up capital stock, and imposed a flat fee of $150; Massachusetts under a reciprocity provision granted an exemption to property of foreign companies; and West Virginia required every foreign insurer to pay taxes as a foreign mutual company. Retaliatory obligations and taxes were provided for foreign reciprocal or inter-insurance exchanges by Iowa.

Fire companies were treated separately by at least two states, Illinois allowing a deduction for amounts paid to certain organized fire departments, and Oklahoma repealing the fire marshal levy as such, but adopting a 5/16 of 1 percent levy for the general fund.

Insurance departments of savings and insurance banks, and savings banks life insurance funds, will be taxed in Connecticut in the same way as domestic mutual life insurance companies.

PUBLIC UTILITY TAXES

Continuation of certain temporary levies on public utilities in general was provided for by New York and Pennsylvania. Utility regulation taxes were adopted by New Mexico and Utah, while Wyoming made provision for a rate investigation fund.

Taxes on specific types of utilities were adopted by New Jersey which revised the railroad tax law, taxed railroad property at 3 percent, and imposed a franchise tax on earnings, by Oregon which increased the tax on ships in intercoastal and foreign trade to 1 percent of the current consolidated levy, by Texas which varied the rates on gas, electric, and water companies to range from 0.44

percent to 1.5125 percent (dependent on size of town or city of operation), limited the taxes to be imposed on utilities for use of the streets to 2 percent, increased the gross receipts tax on telephone companies operating in cities over 10,000 population to 2.275 percent, and imposed a 2.2 percent gross receipts tax on motor bus companies, motor carriers, and contract carriers, and by Vermont which fixed the rate on railroad property at 1¼ percent. Other laws repealed the 4 percent gross receipts levy on private toll bridges and ferries in Arkansas, and resubjected Tennessee gas companies to a 1½ percent municipal gross receipts tax in lieu of a 3 percent state tax.

Electric cooperatives were exempted from certain taxes by Connecticut, Iowa, and North Carolina. In lieu of personal property taxes, rural electric cooperatives in North Dakota will be required to pay 1 percent of their gross receipts for five years and 2 percent thereafter, while a straight 2 percent "in lieu" tax will be exacted of South Dakota rural electrification companies. Washington provided for an additional 2 percent tax on retail sales of electric energy by public utility districts.

CHAIN STORE TAXES

Utah joined the chain store tax list in 1941 with something new in the way of rates. Under the Utah law, new stores thereafter opened will pay ten times the $50 to $500 rates applicable to stores already in existence. The maximum rates apply on stores in chains containing 500 or more stores, and "chain" includes stores both in and out of Utah.

A revised schedule will be in effect in Florida which provides $10 to $400 rates (maximum on chains of 50 or more stores wherever located), plus a tax of $10 per $1,000 of merchandise on hand or warehoused; the former unconstitutional gross receipts tax was specifically repealed.

The application of chain store taxes was modified by Colorado, Iowa, Tennessee, and Texas. The first and last redefined "store" to exclude gasoline filling stations dealing primarily (75 percent) in petroleum products. The Iowa change was minor, while that in Tennessee made the tax applicable to retail stores with group purchasing and common management, common ownership of a majority of the stock of separate corporations, or common ownership of a majority interest.

ASSESSMENT OF PROPERTY

Comprehensive laws on assessment were adopted by California, Florida, North Dakota, and Oregon. The Iowa law provided for assessments at 60 percent, instead of 100 percent, of actual value. In Nebraska, provision was made for assessing back taxes on the personal property of a decedent. Vermont required all tangible per-

sonal property to be set in the list of the community where located, irrespective of the residence of the owner. Georgia limited the jurisdiction of the State Board of Tax Appeals to matters of assessment (transferring others to the State Revenue Commissioner).

Utility property was made subject to special assessment provisions by New Hampshire, which adopted regulations for taxing petroleum pipe lines, by New Jersey which revised the railroad tax law, by North Dakota which provided for giving consideration to valuations by the Public Service Commission and the Interstate Commerce Commission, by Ohio which provided for assessing certain property of non-profit rural electric companies at 50 percent of its value, by Oregon which extended the jurisdiction of the Tax Commission to the assessment of certain cooperatives and mutual organizations, by South Dakota which provided for local taxation of non-operating telephone property, and by Utah which limited the valuation of the property of non-profit electric corporations to the result obtained by multiplying $50 by the number of miles of primary distribution or transmission lines.

Assessment of equities in public lands was provided for by Idaho, Oklahoma, and Washington.

Other laws for the assessment of particular kinds of property include those of Idaho which provided for separate assessment of surface rights in certain mineral lands, of Iowa which set a 30 percent valuation on agricultural produce stored by the producer for more than one year, by Kansas which reduced to 20 percent the valuations for land upon which shelter belts or windbreaks of trees or shrubs have been constructed, by Minnesota which regulated assessments of iron ore in stockpiles, and silicious, manganiferous, and Mesabi-Bessemer ore, and reclassified livestock, poultry, horses, mules, tools, etc., at 20 percent (instead of 10 percent) of their value.

INTANGIBLE PROPERTY TAXES

A new intangible personal property tax act was adopted by Florida, and numerous amendments were made to the laws of Michigan and North Carolina. Among the features of the Michigan amendments was the adding of land contracts receivable, real estate and chattel mortgages receivable, and conditional sales contracts receivable to the list of intangibles, while the Florida act provided for four classes of property with rates ranging from 1/20 of a mill to 3 mills.

Other rate data of interest include a levy by Georgia of 50 cents per $1,000 on loans by brokers for stock purchases, etc., and $1 per $1,000 on stock of foreign corporations and foreign domesticated corporations, by North Carolina of 30 cents per $100 on beneficial interests of residents and non-residents having a North Carolina tax situs although held by a foreign fiduciary, by Pennsylvania in continuing the 8-mill bank and corporate loans taxes, and by Vermont

in reducing bank deposit taxes to 4 mills. Pennsylvania provided for taxing property held by joint trustees, etc., some of whom are and some of whom are not, domiciled in Pennsylvania.

In Oklahoma, it was provided that obligations arising out of sales by merchants, etc. which are assigned to non-residents shall (unless prohibited by federal law) be assessed where they would have been taxable if the title thereto had not been transferred. In Ohio, corporations will be required annually to file a list of resident stockholders.

EXEMPTIONS FROM PROPERTY TAXES

(See also above, under Federal-State Relations)

Public-owned property received more than usual attention this year. Certain municipal airports were made exempt in Maine, New Hampshire, and Washington, while railroad property of a municipal corporation in New York and property of incorporated fire companies in Maryland were also added to the exempt list. Illinois declared in favor of exemption for property belonging to the State Public Building Authority, while New Jersey, although exempting the Delaware River Bridge, held other real property of the Joint Commission to be taxable. Connecticut rendered taxable all property held in trust for a county but leased for private purposes. North Dakota proposed a constitutional amendment to permit local taxation of state-owned lands.

Exemptions to individuals were granted, amended, or curtailed, as follows: Florida—granted to pleasure boats of non-residents; Indiana—granted \$1,000 exemption to disabled (10 percent) World War veterans and their widows; Iowa—granted to dependent widowed mother of deceased veteran; Maine — reduced exemption of Civil War veterans and their widows from \$5,000 to \$3,500; Maryland—authorized Baltimore to repeal the \$500 limit on household furniture exemption; Massachusetts — granted \$1,000 exemption to stored household furniture; Nevada—made veterans exemption applicable to separate or community property; New Hampshire — granted \$1,000 exemption to ex-service men owning property not exceeding \$5,000; North Carolina—granted to farm products held by producer or cooperative in year following that in which grown; North Dakota—granted to new farm machinery during first year after purchase; Wisconsin — granted to new farm machinery stocked and owned by a retailer for farm use. Of interest too is a Pennsylvania act which exempted the proceeds of life insurance policies held in whole or in part by the insurer from the county personal property tax.

Institutional exemptions were granted during 1941 as follows: Delaware—Delaware Anti-Tuberculosis Society; Maine—Red Cross; Michigan — real estate of girl scout or boy scout organizations; New Hampshire—Red Cross and Veterans of Foreign Wars; North

Carolina—non-profitable charitable hospitals even though charges are imposed on patients able to pay for service; Ohio—non-profit cemetery associations; Wisconsin — Wisconsin Home and Farm School, and memorial halls of disabled American Veterans. By a Vermont act, property hereafter acquired by an educational or fraternal institution shall be carried at its value at the time of the quadrennial appraisal before acquisition, and shall not be exempt unless the local voters so approve. Certain exemptions were accorded housing authorities by Delaware and New York.

Exemptions to new business were not extensive this year. Among the laws granting exemptions were three applicable to Macon, Georgia; Cumberland, Rhode Island; and Dillon County, South Carolina. In addition, Oregon allowed an exemption to very small cooperative and mutual telephone systems, and Georgia proposed a constitutional amendment to exempt membership corporations engaging in rural electrification.

COLLECTION OF PROPERTY TAXES

General collection legislation was adopted by California, Florida, and West Virginia, and a revision of the law on collecting delinquent taxes was enacted in New Mexico. Legislation permitting instalment payments was passed by Pennsylvania and Tennessee, while a constitutional amendment to that end was proposed by Wisconsin. Deduction of delinquent taxes from the salaries of state and local government employees was authorized by Indiana. An Oregon act required counties to institute action for the collection of property taxes not paid within one year of the date of delinquency, and immediately upon delinquency in the case of personal property. Provision was made in Kansas and Tennessee for the appointment of receivers for property upon which taxes are delinquent, and the Treasurer of New York City was directed to act as the receiver of rents, etc., during tax foreclosure proceedings. Certain penalties for delinquency were reduced for New York villages. Contracts for the collection of delinquent personal property taxes were authorized by North Dakota.

The time for paying current taxes without certain penalties or interest was extended by Arizona, Florida, Kansas, Minnesota, Montana, Nebraska, North Dakota, Oklahoma, Pennsylvania, South Carolina, South Dakota, Texas, and Wisconsin. Contracts for payment of delinquent taxes in instalments over a period of years were authorized by Illinois, Minnesota, New Jersey (including railroad property taxes), North Dakota, Pennsylvania, South Dakota, and Washington. California, Pennsylvania, and South Dakota waived certain penalties and interest incident to redemption, provided payment is made by a designated date. Time limits on the enforcement of collection of certain overdue taxes were imposed by Connecticut, Florida, Idaho, and Ohio.

New tax sale legislation was adopted by Kansas, and bulk tax sales were provided for by New York. The sale or lease of unredeemed tax title lands was regulated by acts in Maryland and Montana, while another Montana law reduced the period of redemption to three years. North Dakota revised the procedure to be followed upon expiration of the period of redemption, and Arkansas set up a plan to authorize the revaluation of tax lands and redemption upon the revalued basis. By a New Mexico law, counties were required to transfer tax lands to the state. A tax deed in Wyoming was established as prima facie evidence of title.

PRESIDENT MAXWELL: An important organization in the tax field is the Federation of Tax Administrators, with headquarters in Chicago. Mr. Albert Lepawsky is the very efficient executive director of that organization, and he will be good enough to discuss for the conference the "Impact of the National Defense Program on State and Local Finances."

IMPACT OF NATIONAL DEFENSE ON STATE AND LOCAL FINANCES

ALBERT LEPAWSKY

Executive Director, Federation of Tax Administrators

One of the foreboding fiscal phases of the American defense program is the quiescence that prevails on the subject of state and local finances. Once the nation decided to take sides in the present world conflict, there was, on the federal level, a creditable effort in official thinking and administrative action with respect to armament expenditures, defense borrowing, inflationary controls, and federal taxation. But with respect to the financial rôle of our states and cities, we do not have even the beginnings of a national policy.

There is one good reason why we are apparently unworried about state and local finances. The defense program, like most of the early stages of a war economy, has led to improved business and increased tax collections. Like the farmer who will not patch his barn roof when the sun is shining and cannot do so when it is raining, our states and cities seldom worry when their revenues are booming, and can do nothing but worry when they go on the skids. The scheduling of this paper for the opening session of the 34th National Tax Conference, like last winter's Tuscaloosa Conference on "National Defense and State Finance" held at the University of Alabama in cooperation with the Federation of Tax Administrators, and the recent forward-looking deliberations of the Municipal Finance Officers Association, is a timely recognition of the fact that while things are quiet on the state and local front, it may be desirable to do some scouting and mapping of the terrain that lies ahead.

For comparative purposes, it might also be well to recall our experiences during the first World War. In February, 1917, a call went forth for a nation-wide Council of the States on Federal and State Taxation to deal with the question of "Federal encroachment on State's rights" resulting from the increase in federal death taxes. In April, war was declared, and by November, when the council met, the attitude of the states was well expressed by one of the delegates as follows: "In time of war Uncle Sam has the right of way in taxation. If need be he can have the whole highway. The States and cities will bump along on the roadside, in the ditches, or build new roads through the fields."

In terms of actual dollar revenues, the states and the cities did not do too badly during the first World War. However, what appeared to be substantial increases in state and local revenues were drained away by the reduced value of the dollar as a result of inflation. Between 1915 and 1919, there was a 44 per cent increase in state tax collections and a 36 per cent increase in local tax collections (i.e., for cities over 30,000), but so drastic was the inflation that in terms of the value of the 1915 dollar, the adjusted per capita tax receipt figures really showed a 19 per cent decline for the states and a 27 per cent decline for the cities in spite of a real adjusted increase for the federal government of 481 per cent.

	Tax Collections		Percentage Increase or Decrease, 1915-1919, in 1915 Dollars
	1915	*1919*	
Federal	$415,669,646	$4,315,284,978	+481
States	365,543,797	527,819,167	— 19
Cities (over 30,000)	641,972,943	874,582,760	— 27

On the expenditure side, the actual shifts in the period of the first World War were even more apparent with the adjusted figures in terms of 1915 dollars showing a federal increase between 1915 and 1919 of 1374 percent as against a state decline of 24 percent and a city decline of 34 percent. Again these reductions took place in spite of increases in the actual dollar expenditure figures.

	Expenditures		Percentage Increase or Decrease, 1915-1919, in 1915 Dollars
	1915	*1919*	
Federal	$760,586,802	$18,952,141,180	+1374
States	494,907,084	640,403,134	— 24
Cities (over 30,000)	996,061,502	1,113,599,879	— 34

Governmental debt figures too showed a downward trend in per capita adjusted terms between 1915 and 1919. While the adjusted federal debt figure increased 1100 percent, state debt decreased 28 percent and local debt decreased 38 percent.

	Gross Debt		Percentage Increase or Decrease, 1915-1919, in 1915 Dollars
	1915	*1919*	
Federal	$1,191,264,000	$25,482,034,000	+1100
States	532,713,000	693,623,000	— 28
Cities (over 30,000) ..	3,305,260,000	3,904,354,000	— 38

During the present World War period, the trends of the financial figures for our states and cities may not be far different. State tax collections for the fiscal year 1941 are 7 percent higher than for 1940, which in turn were 7 percent above 1939. Eleven out of the 37 states whose fiscal years ended by June 30, 1941 reported increases of ten percent or more in their tax collections. Census Bureau figures show that outstanding among increased tax collections this year is the 17 percent rise in state income tax collections, while general sales tax collections are up 13 percent. For the first time in several years, many states reported surpluses. New York has a $7,000,000 surplus, and Illinois reported a surplus of $6,000,000 in June, with the balance rising to $23,000,000 by September, 1941. Poor Connecticut is burdened with a $3,000,000 surplus, which according to law it can use to retire state bonds or deposit in mutual savings banks—only the bondholders do not want to sell and the banks do not want to accept deposits.

Under such circumstances, the best solution for this temporary affluence may be to invest state and local surplus funds in federal defense bonds. The State of Washington has invested $325,000 in this unique manner, circumventing the $50,000 maximum, it is said, by making the investment from several independent state funds. How Texas is going to handle its $11,000,000 cash reserve which it is hoping to invest in the same patriotic manner is a mystery. Perhaps it will have to content itself as did rich Belleville, N. J., the first city to buy defense bonds, with a paltry $50,000 purchase of so-called Series F.

The state and local debt situation at the present time is also a favorable one, having risen but slightly during the decade of the 30's. While the federal debt increased $26.8 billion, the increase in state and local debt has been only about $2 billion, rising from 17,985 millions to an estimated $19,900 millions. Indeed since 1935 municipal per capita debt seems to have been decreasing in cities over 30,000 population.

So far as our local governments are concerned, the curve also seems to be an upward one, but in any case, much less so than that of the states. While state tax collections rose from approximately 3.8 billions in 1938 to 4.2 billions, the local trend is estimated as rising from 4.9 billions to only 5 billions. Thus in spite of an over-all tax collection that is greater than the states', local tax collections seem to have grown much less and perhaps even less than the increase in the price level. As a matter of fact, the available 1939 tax collection data for 31 out of 94 cities over 100,000 population show a decline in tax collections from $260,527,000 to $259,-575,000. It is safer, however, to speak of a stabilization, rather than an increase or decrease in local revenues, especially in view of the steady decline in property tax delinquency since 1933, and in view of the fairly good collection record for special city taxes like the sales tax in New York City (totaling $55,000,000 in 1941) and the income tax in Philadelphia (amounting to $16,000,000 in 1940).

This general tendency toward stabilized revenues is also apparent for the states. For the last three years, no major state tax has varied as much as 2 percent in the proportion which it yielded of the total state revenue. This relative stability in the face of shifting total revenues suggests that state and local tax collections may oscillate primarily with the trends in production and business during the course of the defense program.

	1939	*1940*	*1941* (est.)
Sales taxes	38.4	39.5	40.0
Unemployment Compensation	20.6	20.2	20.0
Taxes on specific businesses	10.5	10.6	10.0
Income taxes	8.6	8.6	9.0
Motor vehicle licenses	9.4	9.3	9.0
Property taxes	6.6	6.3	6.0
All other state taxes	5.9	5.5	6.0
Total	100.0	100.0	100.0

Judging from the astronomical tendencies of our defense production program up until now, and the increasing military victories and continued seizures of new industrial capacity by the opposition, all of which will call for still greater effort on our part in the near future, business—if this sordid business may be called a business—is on the whole likely to get better before it gets worse. Director William Knudsen of the OPM, speaking in Chicago three weeks ago, cited figures with regard to raw materials and plants that show how deeply we are still engrossed in the tooling stage, with planty of production to follow. To date 20,000 supply contracts of $10,000 or over have been let, with a value exceeding $14 billion;

2,750 new plants and additions have been built, worth $4.8 billion. Every airplane plant in the United States has been enlarged and seven new ones have been built. 165 ways for merchant ships have been built, 131 ships are to be completed in '41, 561 in '42. The demand for raw materials has increased in amount from 33 percent in rubber to 250 percent in brass for 1941; and in 1942, expected increases are 45 percent in rubber, 314 percent in aluminum and 393 percent in brass.

Here and there, the curve begins to bend downward. Non-defense plants are already beginning to feel the pinch of priorities, automobile production cuts have just gone into effect, gasoline rationing has begun on the east coast for want of transport facilities. Along with these developments, immediate losses are expected in some states, specifically in the sales tax or motor vehicle licenses, in state gasoline tax revenues and even city license revenues. But with a national income that is still rising to a figure of over 90 billion, with specific trade, service and manufacturing indices still on the increase, the tax base for state revenues, and to some extent for local revenues, is not yet shrinking.

It is likely that state and city revenues will sooner suffer from the competition of federal taxes. The 1941 Federal Revenue Act recently passed provides for increases in the income tax, increased amusement, luxury and other excises, increased taxes on automotive equipment, accessories and new cars. The new flat $5 automobile tax is in effect a new federal registration fee added to state motor vehicle taxes. Liquor, amusement and other luxury taxes will have their effect on the elastic consumption of these goods and thus upon state luxury taxes which account for as much as 20 per cent of the revenues in some states. Already, some state liquor boards have slashed their tax mark-up in order to offset new federal taxes. With regard to the federal income tax increase, there will be an immediate effect on state income tax collections since 23 of the 34 income tax states permit deductions of federal taxes from taxable income. Moreover, there is already pressure for such deductions in the other states, not to speak of the possible pressure on state legislatures for income tax reductions resulting from the increasing inequalities as between the income tax states and the non-income tax states. Taxpayer morale generally may begin to drop from its present satisfactory level, and enforcement problems, particularly in city revenue matters, have already begun to intensify.

The flexibility the states had in their revenue systems at the time of the first World War, which permitted them to accommodate themselves to the necessary competition of federal taxes by shifting to new and unused taxes, is largely lost today by virtue of the fact that the slack has mostly been taken up and that there are few new taxes left. By 1917, only a half dozen states had enacted the income tax, but today there are 34. General sales taxes were completely

unknown; today twenty-two of our states use the sales tax as a leading source of revenue. Special sales taxes, like the cigarette or tobacco taxes, did not get started until the early '20's, but they have now been enacted in 28 of our states. The gasoline tax, completely unknown until 1919, is the principal source of state revenue and is found in every one of our 48 states today. Even our city tax systems have grown more varied than they were, what with sales taxes, income taxes, tobacco taxes in some of the larger cities, and license revenues as well as special service charges in cities both large and small. In all these respects, we have used up the tax reserves which were available to us during the first World War, and which gave us a certain amount of flexibility both during the war years and the post-war deprsssion.

Moreover, the defense program has stepped up the range of federal activities to such a point that tax exemptions of federal instrumentalities and related exemption claims has caused tension between federal officers and state and local revenue officers, and only by the most patient administrative measures have these problems been solved. Taxation of transactions on federal reservations, especially national parks and CCC camps, had long been a sore spot even before the defense program got started. Under the Hayden-Cartwright Act, the problem was partially solved so far as gasoline sales were concerned by restricting exemptions to federal personnel, but state gasoline tax administrators still lacked auditing powers and they continued to report violations which were contrary to federal regulations but which they were powerless to stop.

In 1940, the Buck Act enacted the same principle as against all transactions, thus applying the sales tax, tobacco tax, etc., to federal reservations. With the growth of the vast number of army camps and cantonments that were good-sized towns in themselves, constantly being visited by citizens and unofficial personnel, state revenues would have been seriously endangered, were it not for the Buck Act. Nevertheless, legal and administrative questions concerning the status of post exchanges, officers clubs, naval stores and their growing business with the rapidly growing military personnel, continued to arise and some remain unsolved. I remember the steady bombardment of inquiries from state tax officials, attorneys general and military personnel that kept our staff at the Federation of Tax Administrators hopping around for months in order to keep internecine warfare here and there from overshadowing the nation's preparations for the main show itself.

You would never know from this type of warfare that Congress has specifically exempted local and state governments from the whole series of new taxes in the 1941 Tax Bill, or that several states including Connecticut, New Mexico and Washington, were facilitating the installment purchase of federal defense bonds by their employees, by authorizing regular salary deductions. The tax conflicts that did

go on were not really serious, mainly a matter of the legalistic bent of the American mind coming to the fore in a burst of enthusiasm to uphold the majesty of the law of the sovereign states. It was confused some time by the state revenue departments holding one way, the state attorneys general holding another, and the state legislatures stepping in with a sonorous statute to hold a third. But this is no funnier than the evidence of administrative collaboration on the federal level, where the War Department took one stand, the Navy another and the United States Department of Justice tried to straddle the two or dig its head in the sand entirely and refuse to decide.

Following these preliminary jousts, and with the assistance of the organizations of revenue officials and their official secretariat in Chicago, there has recently been a satisfactory degree of administrative adjustment on the federal-state and federal-city fronts, with one exception when the war started again over the taxation of British-owned factories operating in the United States. The City of Detroit has levied taxes amounting to $152,000 against property owned by the British Purchasing Commission there, which were due July 15 but not paid. On the other hand, according to another report, the British Government paid the county of Los Angeles one claim for $180,000 but did not pay another similar claim. The attorney general of California has ruled that British-owned property is not immune from taxation, but the chairman of the Washington Tax Commission, also a member of the Pacific Empire, ruled to the contrary.

The whole question seems to be in the process of solution by the simple expedient, which had been planned in any case under the Lease-Lend Bill, of transferring title from King George to Uncle Sam.

In the same manner, the large number of cost-plus-fixed fee contractors operating under the defense construction and manufacturing program are now definitely exempt from state sales and use taxes, but the states are valiantly going after subcontractors under these cost-plus contractors. On his end of the scale, the buck private is not being permitted to get away with too much even under the Buck Act, for on his mechanized maneuvers, when his post exchange system is not working up to par, or when he goes into town for his Saturday night, he's nipped for the tax like his brother-in-arms, the factory worker or office clerk. I don't know whether it's the spirit of the righteous judge or the leery constable that inspires some of my law-abiding colleagues in the tax field to step up their personnel and inspections during maneuvers. In any case, none of them are as vindictive as the port-of-entry tax inspectors who compelled the Army to break up some of its panzer columns during recent maneuvers in order to conform with local regulations, or the bridge-keeper on the Potomac who held up two approaching enemy columns

for nonpayment of toll, in spite of the claim by the Reds that the bridge had been constructed by the U. S. Army Engineers with PWA funds, and the claim by the Blacks that they had theoretically destroyed and reconstructed the bridge during the maneuvers anyhow.

All of this Revenue Americana, however, is merely by way of introduction to the admirable record of state and local activities and expenditures for defense purposes. The serious rôle played by the states in the defense program and its many ramifications can be thoroughly appreciated by a study of some 550 new defense statutes which have been passed in the past year and a half. State defense councils are established now in all of the states, and provision for their financial support ranges from a few thousand dollars in several states to $200,000 in Indiana and $2,000,000 in Maine. Forty-four states now have state guard units, 30 now authorize local governments to construct and operate airports as part of the defense program, 17 passed anti-sabotage acts, 15 enacted the model explosives control bill, others have passed local defense housing bills and similar acts directed at the problems of defense areas.

The added cost of enforcing these state programs, though considerable in some states, is nowhere as burdensome as the rising municipal budgets in so-called defense areas. In May it was estimated that there were as many as 400 cities that had become " boom towns " as the result of the establishment of defense industries or military encampments. Charleston, Indiana, a sleepy Ohio River town of 936 people, 15 miles north of Louisville, suddenly found itself the site of a powder and bag loading plant to cost 25 million dollars, but which as a result of the added Axis victories and our own sky-rocketing defense program, was boosted to a 75 million dollar project before its completion. Twenty-six thousand construction workers have moved into the general area of Charleston besides a good crew of managers, consultants and planners that are trying to keep it from becoming a " trailer-trash " town today or America's Ghost Town Number One after the defense program is finished. Yet, Charleston is being provided with a water supply, a sewage system, highways, police and fire protection, schools, parks and public housing.

San Diego, California has to support 50,000 new people today in addition to the 200,000 which the census-takers found there in March, 1940. Since the invasion of Poland, Alexandria, La., which is the center for Camps Livingstone, Beauregard and Claiborne, has seen its population more than double from 17,000 to 40,000, and its municipal budget expand accordingly. San Luis Obispo took on 50,000 soldiers in addition to its 9,000 population. Bremerton, Washington, trebled its 15,000 population in order to man the Puget Sound Navy Yard. Meanwhile, on our other ocean, Wilmington, North Carolina, grew in one year from 37,000 to 64,000, with the expected rise in its tax rate.

Of the 900 cities with vocational, trade, or industrial schools, 300 now have their school systems operating on a 24-hour basis with the objective of training the 2,000,000 defense workers requested by OPM. One thousand cities have local defense councils and many have established their own home guard units. More and more municipal airports are offering their facilities to the civil aeronautics defense training program. Hundreds of cities, under the program of the Office of Civilian Defense, and all of the Massachusetts cities previous to the establishment of that program, have organized full-fledged air-raid precaution and training schemes with their warning system, warden system, control and report centers, messenger and communication system, first-aid and casualty system, auxiliary fire, gas identification and decontamination, auxiliary police, repair and salvage gangs, identification centers, evacuation planning, hospital census, air-raid spotting system and military liaison. Practically, the whole of this expense is being borne voluntarily by cities throughout the nation, only two states, Utah and Massachusetts, having given their local governments special authority to levy taxes for defense programs.

On the tax side alone, states and cities are making several concessions in their desire to cooperate with the defense program. Twenty-one states have enacted tax concessions for defense industries; practically all of the income tax states have now enacted the new federal depreciation provisions in order to facilitate defense industry accounting and taxation, and tax concessions of a half dozen different sorts have been enacted for enlisted men in 15 states. State sales tax administrators were among the first to forego the use of metals for their tax tokens, and are now seeking plastic substitutes with such small success that they may have to go back to the original Missouri milk-top tokens of the early days of sales tax administration. An interesting illustration by tax officials is reported from the West Coast where the Navy has used the elaborate property tax records of the local tax assessor's office in order to set up a master file of small craft which might be employed as auxiliary and scouting vessels in case of emergency.

The burden of financing these activities is not all left to the states and the cities, since the normal system of federal air is being geared into the defense program. The U. S. Office of Education's grants for vocational education have been increased from the pre-defense level of around $20 million to the sum of $116 million. Federal Works Agency regular highway funds have been allocated for 4,000 miles of new defense highways besides improvements on 15,000 more miles representing an expenditure of $98 million in regular federal aid funds on $176 worth of defense highway construction. By September 20th defense dwelling units totaling 90,498 were being built or had been completed. While the new WPA bill, amounting

to $911 million is a 33 percent reduction over last year, preferential treatment is given under the new bill to certified defense projects.

A more direct type of aid to local authorities is furnished by the Lanham Act or the Community Facilities Act which provides $150,000,000 for grants or loans to localities whose services are over-taxed by defense establishments. The original estimate of the Director of Defense Health and Welfare totalled $272 million when submitted. Only 85 projects totalling $125 million have been approved, 33 of them for schools. It is an interesting counterpoise to this educational bias of ours even during the defense emergency, that of the $6,500,000 granted to our "Western Communities", $980,000 of it went to Hawaii for its city water system. Thus does American localism meet imperialism in a world at war.

There is some evidence that this liberal federal defense aid to cities is being supplemented by a continuation of the already extensive system of state grants. California in 1940 paid out to local governments, in grants and shared taxes, $131,473,000 or 46.3 percent of the state budget, as compared with 42.2 percent in 1938. The Governor of New York estimated in his budget message for 1941-42 that the state would share with its local governments $270,-563,000 or 58.9 percent of New York's anticipated tax collections.

It is thus our system of grants and aids which in war or peace gives an element of workability to an otherwise rigid and somewhat static revenue system on the state and local level. In 1938, one out of every seven tax dollars ended up with a level of government other than the one which collected it. Thirteen percent of all federal tax revenues were granted back to the states and the local governments, and 36 percent of all state tax revenues are granted back or shared with their cities and localities. So far as these cities are concerned, were it not for the part played by the federal government in the last few years, it is possible that our entire system of local services and taxation might have broken down. Since 1934, from 20 to 25 percent of the funds available each year for local expenditures (including WPA funds contributed indirectly through the states) have come from the federal government. And in spite of defense and recovery, the need for grants to both states and cities remains unabated.

These persistent trends give a long-range setting to the subject of the impact of the defense program on state and local revenues. Revenue rationalization is a continuous problem and a dynamic process transcending peace and war, local, state and federal government. In opening the 1st National Tax Conference in 1907, its permanent chairman, Governor Guild of Massachusetts, said, "With the possible exception of municipal rule, taxation is the phase of popular government in which the United States so far has made its most conspicuous failure. We have a certain fixed system of internal revenue, and custom dues as a source of national income,

but beyond that is chaos. . . . There is absolutely no uniformity in taxation, and industries are transferred from one commonwealth to another by the exemption from taxation in certain states of classes and corporations that cannot be exempted under local laws in other states. . . . The time is ripe for a clear understanding among the commonwealths as to . . . which taxes should be reserved for national, which for state and which for local revenues." We are further from that understanding than ever before. But on the other hand, events have brought about adjustments of an unexpected nature which have varied new problems and in the minds of some created new doubts and new fears.

Yet we must have in mind a hypothesis, an historical framework in which we believe and by means of which we may measure our deviations of fact and thereby change our minds accordingly. (The fact that we can change our minds, I am told is the best sign we have one.) What I have in mind is this: Crisis periods like the present lead to far-reaching adjustments that tend to stretch out the long arm of centralization, and that tax coordination inevitably means more national or central control over more and more of our revenue system. The belief that tax coordination can mean anything but a form of national centralization over policy is, I fear, a pious hope, except in the sense that there may be along with centralization a wider devolution of certain kinds of decisions through home rule or local autonomy or regional experiments like TVA. It is not merely a question of our preferences in the matter. It is, I think, an inexorable historical trend affiliated with our technology, mechanical administrative and psychological.

It is no good to argue that centralization and dictatorship are identical, for the centralizing trends of the democracies we are striving to defend are as drastic as those of the enemy's. Hitler has not yet taken over the local fire departments but Churchill has. Within eight months after the Canadian provinces rejected the Rowell-Sirois report for Dominion absorption of their income and other taxes, they individually agreed to the new centralizing plan. And while the Australian states still carry on in the income tax field, their differential rates have been made uniform by hitching them up to the federal forced savings plan. Perhaps we too sooner than is expected, have to make decisions of a related kind in the revenue field. And there is no assurance that the decision can clearly distinguish between intergovernmental fiscal arrangements and the very structure of our historic federal system itself. In spite of the quiet on the state and local tax front, let us not be surprised by the suddenness of the impact nor daunted by the magnitude of the decisions we may have to make during this critical period.

President Maxwell: I am not sure that I understood all the technical terms that Mr. Lepawsky used, but I think he was putting in a word for our Committee on Coordination of Federal, State and Local Taxes.

In just a minute we will open up for our general discussion of these three very interesting papers we have had this morning, so you will have at least a half-hour for that question. Right at the moment the chair wishes to recognize Mr. Long.

Mr. Long: Mr. Chairman, I hope that the conference will indulge us for a moment in what it is necessary for us to do in order to perpetuate the National Tax Association. I therefore move that the president be authorized to appoint a nominating committee to consist of the ex-presidents who are present and three to be named by the chairman of the conference, and the chairman to be designated by the chairman of the conference. I make that as a motion.

(The motion was duly seconded.)

President Maxwell: It is moved and seconded that the chairman appoint a committee on nominations. Is there any discussion? All in favor of that motion will please say, "Aye."

(Ayes.)

President Maxwell: Opposed, "No."

(None.)

President Maxwell: The committee will be announced probably in the afternoon session.

There are two other committees that should be appointed. One is a committee on credentials. The chair will appoint on that committee Mr. Zoercher of Indiana as chairman, Mr. Stevens of California, and Mr. McLaughlin of Connecticut.

Perhaps the most important committee of the conference is the committee on resolutions. According to the by-laws of the organization, each state has one member on that committee, and the delegates present at the conference are requested to get together and designate the member of thir group for service on the committee on resolutions and hand in that name to the secretary, if you please.

The chair will appoint as chairman of that committee Mr. Query of South Carolina, who for so many years served the association so well as its secretary.

There have been a good many wisecracks about the relation between North and South Carolina, but I am happy to say that we are on as friendly terms as the Canadian government and the United States government, or St. Paul and Minneapolis.

Mr. Query some years ago formed the very good habit of going over into the mountains of western North Carolina every year to select just the right kind of wood to present to the president of this

association, and although he terminated his service as secretary, I am glad to see that he is keeping up that good habit.

The conference is now open for discussion of the three papers we have had this morning. The chairman suggests that we discuss first the paper of Mr. Hoan, because he will be wanting to leave the conference.

LEO MATTERSDORF (New York): Mr. Chairman, as long as there is no discussion, may I introduce two resolutions?

MR. LONG: Mr. Chairman, I think perhaps if Mr. Mattersdorf will waive that for a second, I would like to ask Mr. Hoan what city it was that made this splendid contribution to American political economy?

PRESIDENT MAXWELL: Mr. Hoan is on the spot.

MR. HOAN: It was the city of Milwaukee.

PRESIDENT MAXWELL: Mr. Hoan had no hesitancy in answering that question.

MR. MATTERSDORF: May I read the resolution?

PRESIDENT MAXWELL: Yes.

MR. MATTERSDORF: "Whereas, the Committee on Allocation of Income of the National Tax Association in a report rendered to the Thirty-Second Annual Conference on Taxation held at San Francisco, California in 1939 has arrived at certain conclusions and made certain recommendations with respect to allocation formulae where taxes are based on or measured by net income, and

"Whereas, the said report has been discussed at this conference, now, therefore,

"Be it resolved, that the Thirty-Fourth Annual Conference on Taxation approves the report and favors the adoption of the recommendations of the Committee on Allocation of Income by all states and territories of the United States levying taxes on net income or franchise taxes measured by net income."

PRESIDENT MAXWELL: That will be referred to the Committee on Resolutions.

MR. MATTERSDORF: The second resolution:

"Whereas, the National Tax Association has on divers occasions considered the subject of allocation of income for the purpose of state taxation, and

"Whereas, the desirable objective of uniformity in the use of applicable factors for apportionment may be difficult to achieve through individual state legislation, therefore,

"Be and it hereby is resolved, that the Thirty-Fourth Annual Conference on Taxation sponsored by the National Tax Association

favors a federal enactment by the Congress of the United States under the commerce clause of the constitution providing a formula, the application of which shall determine whether the apportionment of net income for the purpose of net income taxes or franchise taxes measured by net income by a state imposes a burden on interstate commerce to the end that by such federal standard the excess tax imposed by the taxing state over that which would result is measured by the federal allocation formula shall be deemed a burden on interstate commerce."

PRESIDENT MAXWELL: That will be referred to the Committee on Resolutions.

Gentlemen, these discussion periods ought to be an interesting feature of our conference, and I hope anyone present who has any view he wishes to express within the limitation of the rule as to time will not hesitate to take the floor.

CHARLES W. GERSTENBERG (New York): May I suggest that Mr. Hoan, if he feels like it, tell us in a few words just what—I presume I am very ignorant in asking this question—the Civilian Defense Office is doing at the present moment. How far do they feel their organization has proceeded? How much more is necessary to be done? We would like to carry some of that off to our little villages.

PRESIDENT MAXWELL: Mr. Hoan, will you be good enough to enlighten the gentleman from New York?

MR. HOAN: As you understand, this Office of Civilian Defense started out as the Division of State and Local Cooperation. The original Council of Defense was not assumed to know much about state or local government, and Frank Bane, the director of the Council of State Governments, was called in to head the division, and he asked me in turn to associate with him as sort of a contact, liaison man, with the local governments. That functioned for a while until it was made more extensive recently, as you know, and Mayor LaGuardia placed at its head.

In the meantime, after the appointment of Frank Bane in the Army, studies were being made on every branch of civil defense. We held back in making announcements of any of these activities until the studies were complete. At the present time, pamphlet after pamphlet is being released going to the state councils of defense which in turn transmit them to the local council where there is complete instructions on every phase of the work, whether it be volunteer participation, volunteers wishing to take part, women and men, or what. There are complete pamphlets on fire hazards, on the fire surveys, and on fire training.

To make a long story short, we have either mailed out pamphlets on every phase of the state councils of defense, or those pamphlets are in the course of preparation and shortly will be released. These

pamphlets are in the hands of every local council of defense, or should be there, and if they are not there, then surely complaint can be made either to the regional director of what corresponds to the army area, or to our office in Washington, and we will see that they are supplied.

If cities haven't organized their local council of defense, of course they may not have received those pamphlets.

It is now the desire of those that are interested in this work that every locality of any considerable size have some sort of organization that will function with the state council and with the regional directors in beginning this training work and this study work that will involve a lot of permanent things. For instance, the permanent health program of civil defense involves this problem of why 40 out of every 100 boys are rejected for service in this country. There is apparently a need for much to be done along health lines, and so on.

I think I have in a general way summarized just how this work is being prepared in pamphlet form, and I don't need to spend time in enumerating what it all is, except to say every phase is thoroughly studied and thoroughly put in the pamphlets. Copies are available for every locality that should have them if they are active enough.

Is that a satisfactory answer?

MR. GERSTENBERG: Very nice. Thank you.

PRESIDENT MAXWELL: Is there further discussion on Mr. Hoan's address?

If not, we will pass on to the next one. Has anyone any sins of omission or commission to point out in Mr. Manning's digest of state legislation, 1941? If not, we will get on to the broad field covered in a broad way by Mr. Lepawsky on the impact of the national defense program on state and local finances.

FRANK J. BRADY (Nebraska): I understood you to mean that centralization was not only necessary but desirable.

MR. LEPAWSKY: I tried to straddle that question, Mr. Chairman, but I see I am being dragged back into the ring. I didn't mean to imply in this talk that centralization was either necessary or desirable, but that it was a more or less inevitable trend.

MR. BRADY: How do you determine what you would term the fact?

MR. LEPAWSKY: You can measure the extent of federal grants-in-aid to the states and through the states to the cities and show the increasing curve of the total American tax dollar which is going for that purpose. You can examine state services and state activities, ranging from highways to social security. You can also see an increasing crescendo of central legislation, central policy-making, central encouragement of these functions. In a similar way, you

can examine state legislation and state administration as over against the local authorities, and notice the same general trend. I don't think centralization merely means administrative centralization in Washington as we have witnessed it in the past eight or ten years. It can also be examined historically and to some extent scientifically by looking at the work carried on in our state capitals over a period of years.

I am trying to stay away from analysis of it and saying I desire it. Perhaps I do. I don't like to say whether or not I do. I would rather we would look at the facts and see what they show over a broad period of years. I don't think you can hide from that very definite development and trend, which is obvious if you study fiscal data, if you study legislation, if you study administration, and if you study it on all levels, not only the federal.

MR. BRADY: Isn't it true, then, if we turn over centralization that we have disfranchised ourselves? Don't we lose control of it? In other words, the authority which collects the money will have the final say in how the money is spent, won't it?

MR. LEPAWSKY: I think to a large extent that is true, yes.

MR. BRADY: And isn't that the very thing we are trying to keep away from today?

MR. LEPAWSKY: I don't know. Are you?

MR. BRADY: From your interpretation of centralization, our whole hue and cry seems to be against dictatorship.

MR. LEPAWSKY: It seems as though historically we have been doing the very thing we want not to do.

MR. BRADY: That is right. Then we ought to change that trend. There isn't a dictatorship that has ever proved itself a success.

MR. LEPAWSKY: Of course, that is one thing I will take issue with you on. I do not think that centralization and dictatorship are synonymous, as I tried to point out in analyzing the trends in other European countries I would regard as sufficiently democratic to enter into this joint defense program, like England, or Australia, and Canada.

MR. BRADY: The point is, if we keep on giving and giving, then we lose interest.

MR. LEPAWSKY: I would like someone else to take up the discussion, Mr. President. I don't want to be put in the position of defending a program I am trying to describe.

MR. GENTRY: May I ask Mr. Lepawsky a question?

Don't you rather mean by your statement in your paper that through the experiences since 1907 it has been indicated that we

have not to this point worked out any program of division of revenue as between the particular fields in which the states and the municipalities and the federal government operate, and if that is a necessity, then there will have to come a time when someone shall take that responsibility, and it would necessarily follow that the federal government being the supreme power, would take the responsibility if we are to get the efficiency that we must have eventually.

MR. LEPAWSKY: I think the tendency toward separating revenues—that is one of the solutions suggested as far back as 1907—is merely one of a variety of means that we have almost unconsciously worked out of bringing a greater degree of coordination into our revenue system in spite of the fact that we insist that our revenue system is uncoordinated. Grants-in-aid have been another means, shared revenues another means, and various other techniques that have been mentioned from time to time, are all part of the series of means we have developed to adjust our federal, state, and local finances.

I think the over-all picture, though, has been one which you might call centralization, and which, depending upon your philosophy, you might regard as either dangerous or desirable, or, as I choose to look at it, historically, morally inevitable.

In saying that, I hope you won't identify my personal opinions with the opinions of the organization that I happen to have been affiliated with. I think most of you know that I have tried to keep opinions out of the work of the Federation of Tax Administrators.

MR. LONG: Mr. Chairman, in answer to the first speaker, who I think sincerely felt that there was an encroachment on state revenues and the functions of states and their political subdivisions, I am fearful that he overlooked what seems to be rather fundamental with us in America, namely, that there is no seizure by the central authority of these rights which he ultimately feels may lead to disfranchisement. But it is rather the neglect of the local communities, his own state, as well as the political subdivisions of his own state, through the period of what might be called prosperity, their neglect of this American right to look out for their own affairs, and having neglected to look out for their own affairs—and all the states are guilty—there has been the necessity of the federal government to intervene, and therefore the states can't stand up and in sincerity say the federal government is seizing this from us.

The states, however, must in part hang their heads in shame by saying, "We just haven't looked out for our own pastures." The federal government has come in to see that those pastures are kept up to what ought to be the reasonable condition for those people.

J. W. HUSTON (Illinois): I want to subscribe to what Mr. Long has said. The same thought occurred to me, and that is that the

people want results, and they will listen to the government that will give them the results that they desire. If the states can give those results in the traditional fields of state activity, then the states will continue to exercise the governmental prerogatives they have. But when the people want certain results, and the states aren't able to give them to them, then we will have the ultimate centralization of power.

I think it is up to the states to exercise their traditional prerogatives in such a way that they will get the results that the people are looking for and want. And in that way we will maintain the sovereignty of the states in about the only way we can.

Hugh Ashmore (Nebraska): I would like to ask Mr. Lepawsky a question, and purely from the standpoint of history and your experience with what is going on.

In your talk you mentioned the collection of taxes by central organizations, state and national, and then redistribution to local government. Does not history reveal the fact that that sort of tax, where it is collected nationally or by states and then redistributed, encourages extravagant government, which goes along to a great extent with waste and inefficiency?

Mr. Lepawsky: I can't answer your question directly. I am going to ask someone else who is a better historian than I am to answer it.

I would like to tell one story, though, which illustrates the danger of our usual responses to a question of that kind. I stopped in British Columbia a couple of months ago to take up their experience on the administration of the income tax collection at the source. I said to the administrator there, who had a couple of decades of very good experience, "You know, we feel in the United States—at least I have carried around the opinion—that collection at the source is dangerous, because a man who pays his own taxes and doesn't let his employer merely deduct it, knows what he is paying, and he will demand economy."

He said, "Now, don't you go any further, young man. I know you are a newcomer in this business. I have been in it for twenty years, and the actual fact is just the contrary, because as soon as you permit collection at the source—as soon as you require taxes to be paid directly, that is—then the taxpayer comes to you and instead of saying, 'Here, I want you to be economical and don't spend my taxes in this way,' he comes to you and says, 'Look here, you are collecting my taxes from me. I know I am paying them, and I want more services than I have been getting before.'"

That is just the contrary to what I had expected would be the experience with regard to collection at the source as against the other type of collection. I cite that merely as an illustration of the dangers of our usual reactions to matters of this kind.

I can't give you a more direct answer, because I am not enough of a student of history; I don't know, frankly. There have been civilizations that apparently have fallen through extreme centralization. There have been others that have fallen through inadequate coordination or centralization of power, democratically arrived at. I personally have faith in the American system as it is developing, enough faith to say that I am not frightened at what has happened in the last decade or so, and I am particularly encouraged by the fact that it is not a party matter, because it seems to me as we look back at our party history, it was the Republican Party that had the tradition of being a centralizing party, as against the Democratic Party, which was the states' rights party.

It seems to me we are a very pragmatic and practical people, and we make up our minds with regard to theories and principles as we go along, and I frankly don't see any explosive or dangerous developments in our system of government so far in the light of our experiences either during the last decade, or, for that matter, since we began this centralizing trend, which was obvious soon after the Civil War in some phases of it.

MR. ASHMORE: I noticed when the rules were read that a man couldn't speak twice. I asked a question and I would like to express an opinion.

PRESIDENT MAXWELL: Proceed.

MR. ASHMORE: The point I would like to make is this: In the Nebraska Legislature, at the last session certain things were proposed to that legislature from the central government at Washington. I just want to repeat the reaction of one speaker on the floor, although the legislature was not very much in favor of this sort of thing. His expression was, "I don't think we ought to look a gift horse in the mouth." I think that is a trend which is dangerous, when we start taking money which in reality is our money directed in a roundabout way.

MR. LONG: Did Nebraska get very much money from the federal government?

MR. ASHMORE: Don't all states get quite a bit?

MR. LONG: No. How much did Nebraska get for public welfare during the period?

MR. ASHMORE: In all phases?

MR. LONG: Yes.

MR. ASHMORE: Well—

MR. LONG: As a matter of fact, the rest of us understood that Nebraska got 100 percent and didn't cough up anything.

MR. ASHMORE: For what?

MR. LONG: For public welfare.

Mr. Ashmore: In just what respect do you mean?

Mr. Long: PWA, WPA, and several other divisions. I am just anxious to get the Nebraska reaction to that overwhelming contribution by the federal government.

Mr. Ashmore: Of course, there is a difference of opinion in Nebraska. Personally, I think it would be just as well if we hadn't got so much.

Mr. Long: I am glad to get that expression.

Franklin S. Edmonds (Pennsylvania): Mr. President, I would like to take part in this discussion because I am very much interested in the question. I want first to say a word with regard to Mayor Hoan's paper. If Mayor Hoan stated there that the railroads used a right of way which was donated by the public, he described a condition which certainly never existed in Pennsylvania nor any of the eastern states. He probably has in mind that large development of railroads from the Mississippi to the Pacific in which the federal government set aside certain sections of land for the use of the railroad which did pay for the right of way. But so far as my knowledge of the eastern railroads is concerned, I would say that the Mayor has judged by western conditions which are not true in the east, where the railroads purchased their own rights of way, and paid for them under condemnation proceedings.

Secondly, I want to say a word about Mr. Manning's paper. I noticed with great pride and satisfaction that there were four states which joined in enacting reciprocity legislation with reference to the death duties on the intangible personal property of non-resident decedents. I did not know that there were four that had enacted such legislation in 1941, but since the decision of the Supreme Court of the United States which took this question out from the federal purview and returned it again to the states, I think there must be 30 or 35 states that have continued their reciprocity statutes and thereby have got rid of the duplicate taxation on the intangibles of non-residents. That, in my judgment, is a striking tribute to the common sense of the American people and their feeling of equity with regard to the two jurisdictions taxing the same thing in the same way at different rates and under different principles.

I hope Mr. Manning in his paper will name those four states that have added themselves to this movement during the past year.

Mr. Long: I think Pennsylvania is one, Senator. We congratulate you.

Senator Edmonds: Pennsylvania enacted it and kept it from the beginning. All the states that followed have followed Pennsylvania, but pride prevented me from saying that.

In the third place, this discussion that has been raised by the gentleman from Nebraska and has been continued by Mr. Lepawsky:

I think Mr. Lepawsky's papers are a real contribution to these conferences. He gives us intimate facts and he gives us tendencies from those facts, and that enables us always to have something to talk about. I want to say to the gentleman from Nebraska that, during the World War, I had rather an intimate association with the very fine division of the National Guard that came from Kansas-Nebraska. I think it was the Thirty-Fifth Division, but it may have been the Thirty-Second; I forget the number. I recall very distinctly when those boys were on leave down at La Bourboule, they made such an excellent record for conduct and for general behavior and gentlemanliness, and one of the members of the staff of that division told me, "You know that this division has 84 percent of its members graduates of a four-year high school course. That is what we do for our boys in Kansas and Nebraska."

When I came home I remembered that, we in Pennsylvania, happy as we are in leading in so many things, did not have 40 percent of our boys graduates of a four-year high school course at that time. It seemed to me to be very clear that if Kansas and Nebraska were setting that kind of standard, we in the rest of the union would have to follow it very shortly.

However, a high school education costs about $200 per pupil, where an elementary school education costs $50 per pupil. Where is the money to come from? Is it to come from the school tax, the school tax being raised in very large measure upon realty? If so, it will add to the burdens of the real estate owner to a degree that might be unbearable. Where, then, should it come from? It has to come in many of the states, and many of the states are now taking part in the same standard that this state has set for itself years ago. It is coming in very large measure by the grants-in-aid which are made by the state government from other forms of taxation for the help of the schools. I personally think that it is a good thing. Does that mean necessarily that the people of the locality that receive that grant have given up to any degree their interest in the schools? I do not so find. Does it mean that they are controlled in any way or coerced so that they must give a four-year education for their sons in the high schools when they perhaps would only want to give one or two years? I know that there are certain people in Pennsylvania who belong to these fine sects that grew there when Pennsylvania was a home of religious freedom, and who insist upon raising their daughters for domestic service and their sons for work on the farm, and there has been quite a situation raised because in Lancaster County, where my friend Reist lives, there were six farmers who sold their farms and bought farms in Maryland, because down in Maryland they claimed they were not subject to the same degree of state control in the education of their children that they were in Pennsylvania. That has happened.

But in general I would say that the locality feels well satisfied to have the state assume a certain portion of the expense of education. My own feeling is that this movement toward coordination has a new angle to it that we have to consider and which is being considered in the very fine committee of which Commissioner Long is the chairman, and that is, administratively, is there any objection to the federal government or the state government, or the state government and the local government, combining for the purpose of working out common administrative problems?

It certainly seems to me to be grossly unfair that we should find the federal government taxing cigarettes at 6 cents a package, and then having—I think Mr. Lepawsky said—28 states laying an additional tax on cigarettes of 2 cents a package, when the whole thing could be collected by the federal government and then appropriately shared with the state. That would mean one tax for the manufacturer, it would mean one set of tax officials, it would mean one set of reports for the industry, it would have the same effect of giving to the state the proportion of additional income that it may need in order to meet these additional functions to which I have referred just a moment ago.

Under those circumstances, why isn't it common sense to work out a proposition of that kind? If it is being worked out in Canada and in Australia, doesn't that afford us an appropriate example for consideration?

I have the feeling that the states are an eternal portion of our government. The use of the word "eternal" in describing the state is one of the subjects that I want to refer to in my paper tomorrow night.

By the way, I am reminded that the federal government has recently called an advertiser to account who sells granite, on the ground that in his advertisement he stated, "Granite is Eternal," whereupon the federal authorities said, "That is a misleading advertisement to the people. There is nothing eternal in the world."

My own belief is that there is something eternal, and I think the existence of the American states and the full performance of their functions is that thing that is eternal. But just as I do not object to the state police force using the Federal Bureau of Investigation when there has been a kidnapping case in order to find the child and the criminal, neither do I object to the federal government and the state government combining or working out some sort of *modus operandi* which can stop the confusion in the taxing system which exists at the present time.

I want to make that as the contribution there, because I don't think that the combination for the performance of a better administrative job will interfere in the slightest degree with the permanence of the states, which I am just as anxious to see maintained as you are. Thank you very much.

ROBERT S. FORD (Michigan): Mr. Chairman, may I comment briefly on that old adage that you should not look a gift horse in the mouth? It seems to me that we should, in the case of these federal grants or allocations to the state. In other words, we should recognize that the problem exists, and Mr. Lepawsky has pointed out the nature and existence of that problem in a very admirable manner.

Considering very briefly the question of educational finance, we should recognize that the federal grants for education will probably grow considerably in future years. Strong groups are clamoring for additional grants-in-aid for education. We might examine that kind of grant to see for what purpose it might be best used. Many people are disturbed over educational grants in federal government because they say they don't want the federal government determining what should be done in the schools. People who are advocating that sort of assistance I believe are placing emphasis upon federal grants for school building construction and maintenance. Buildings, in other words, constitute an important part of our expenditures for education.

If the grants coming from the federal government were confined largely to those PWA type of grants for building construction, and the specification and prescription of standards of construction, there would not be that danger which many people anticipate.

Furthermore, we should recognize its existence. You will all recall here a couple of years ago when President Roosevelt wanted to cut the highway grants to the states by about 150 million dollars. That naturally created a furor in Congress and the measure was not adopted. On the other hand, when the federal government steps in to impose such a thing as a use tax, a $5 use tax on automobiles, infringing upon a state source of revenue, a recognized state source of revenue for many years, in levying an imposition that has no relationship whatsoever to the theory of highway finance, the states ought to take a firm position on it.

In other words, what I am saying is this: that we ought to examine the nature of these federal grants and the states take more initiative in making proposals regarding the nature of those grants.

PRESIDENT MAXWELL: Two brief announcements: There will be a meeting of the executive committee of the National Tax Association at 5:30 this afternoon in Room 1100, on the top floor.

The luncheon will be, contrary to the provision on the program, served in the Terrace Café on the main floor.

Our time is getting a little short. The luncheon is scheduled for 12:30. Are there any other brief comments?

SIMEON E. LELAND (Illinois): I would like to call the attention of the gentleman from Nebraska to the fact that all the evidence that is available on shared revenue, grants, of one sort or another,

gives no reason to believe that there has been any waste or extravagance encouraged as a result of that policy. Rather, on the contrary, the evidence is to the effect that these policies, accompanied as they have been by administrative supervision, have led to an increase both in the quantity and the quality of public service.

I fear that his definition of extravagance runs in terms of any increase in expenditure being labeled as an extravagance. If you adopt that as a definition, then the very purpose of stimulation grants, which are in large part found in the fields of education and public health, and certain other activities, directly lead in that direction because they are made for the purpose of encouraging local governments to undertake public service.

But if you use the word "waste" in the accepted sense, then there is no real evidence that these grants have done anything of that sort. The most that you can say is that the possibility of getting a portion of the revenues, local revenues, from the central government for expenditures, has the effect that it makes the subsidized or activities supported by grants look more easy to attain than other services, with the result that perhaps localities and other governments make appropriations to those items somewhat larger than they otherwise would, with the result that it may change the worth of one particular type of expenditure as against another type, but not that it will encourage waste.

The next difficulty that must be recognized in connection with grants and shared revenues of one kind or another is the tendency which they have to keep in existence forms of government and types of service after the marginal value—after the worth of such services has at least diminished. In other words, one of the tendencies of educational grants has been to keep the one-room schoolhouse far longer than the one-room schoolhouse should have been kept, or to maintain innumerable school districts or innumerable local governments long after the need has passed.

If you want to label that as waste, it is one thing; but it is wise to remember that those units continue to perform some public service, and though they may not be as efficient as they otherwise would be, there is no question but the tendency of our grant policy and our sharing of revenues has been in the direction of improving and decreasing the unit cost of public service, irrespective of what may have happened to the aggregates.

I think we ought to congratulate Mr. Lepawsky on the paper he has given us, because he has pointed out some significant things that seem to me to be deserving of our careful consideration. I think it is one of the best papers we have ever had on that subject.

Mr. Ashmore: Mr. Chairman, in defense I want to say a word more. Two or three of these gentlemen have taken the liberty of reading into my remarks things I didn't say. I asked a question.

It was an honest question. It was a fair question. It wasn't in a critical nature. Personally, I have seen considerable waste in some of these activities where local agencies are concerned. I will give you an illustration: when the first attempt to bring about local relief, direct relief, in the counties, came into the short grass country of southwestern Nebraska, it was all financed by the federal government. I know a man who went to the county-seat and registered, put his name down, as an applicant for relief, who was not entitled to it and knew he wasn't. His excuse was, "If we don't get it, somebody else will."

That is a tendency that is going on in our state today. That is the thought that I had in mind when I asked that question. I didn't get up with the idea of criticizing Mr. Lepawsky. I asked a question. You men have read some things into my remarks that were not there.

Mr. Long: I think we all owe a very deep debt of gratitude to Nebraska for asking the question, because it brought out a very high level of intelligence on the part of some of our college professors here, the University of Michigan, the University of Chicago, competing with each other in the contribution.

I would like to say, for the benefit of those from Nebraska, that this is always a free-for-all fight. We have no feelings about it. But we are likely to hop onto something that we can grab like a pack of dogs to shake out and make a little bit of amusement. I will apologize to Mr. Ashmore of Nebraska and thank him for asking the question.

Mr. Ashmore: I don't want any apologies. I like a fight myself.

Mr. Brady: Mr. Chairman, might I again say something?

I enjoyed your paper very much. I mean no criticism of it. The gentleman who spoke a moment ago said he didn't know of waste. I have the proof in my possession of what is referred to as waste by us, and what we consider waste. The specific case is vocational education. Two weeks prior to June 30th, or the end of the biennium, when the people from the federal government department came down and wanted to pass certain vouchers over my desk without receipts and I wouldn't permit it, they said, "We must get rid of this money before June 30th or it will revert to the general fund," and they supported that with a letter from the federal government. I consider that waste in any government.

Philip Zoercher (Indiana): Mr. Chairman, I move that we adjourn for lunch.

President Maxwell: The conference is indebted to the gentleman from Nebraska for starting this interesting discussion.

The session is adjourned.

(The meeting thereupon adjourned, at twelve-twenty o'clock.)

SECOND SESSION

Monday, October 13, 1:25 P. M.

(Luncheon Session)

President Allen J. Maxwell, presiding.

President Maxwell: Ladies and Gentlemen, this association is a working organization, and it runs on a fairly close schedule.

One of the three stories that I have is one that the late President Taft enjoyed telling at his own expense. He was a guest at a meeting down in my state. When the dinner reached that uncertain stage where the rattling of the dishes began to subside a little, the toastmaster leaned over and inquired, "Should I present you now, or should we let them enjoy themselves a little while longer?"

Simeon Leland had an announcement he wanted to make and he was too bashful to come up here and present it himself. So he asked me to read it for him. "The Illinois Delegation and ladies will have dinner tonight at 6:30 in the Colonial Room on the mezzanine floor of the hotel to elect delegates to the resolutions committee and to transact other business. Mr. J. W. Huston, in charge of arrangements, will have tickets. Entire Illinois contingent expected."

The usual felicitations on the meeting of this association which are usually presented in the morning session are carried over to this occasion. We have with us the Honorable Mayor of the City of St. Paul, who will tell us how glad he is to have us here and what a great city Minneapolis is.

The Hon. John J. McDonough: Mr. President and Ladies and Gentlemen: The President's story about not inflicting any speakers on you but rather letting you go on and enjoy yourselves reminds me of one—and this perhaps is a hint or a tip to all speakers during the conference—of a man who lost his hearing. He went to his doctor. He got the history of the man. Finally he said, "You are drinking too much. That is your trouble. You quit drinking, and your hearing will be restored."

The man did so, and his hearing was restored. He came to the doctor and thanked him. About a month later the doctor met him on the street and said hello to him. The man couldn't hear him. So he shouted. He said, "Weren't you the man who was in to see me and I told you to stop drinking and your hearing would be restored, and you found that that was true, that it was restored?"

He said, "Yes."

"Have you gone back to drinking?"

He said, "Yes."

The doctor said, "Why? You knew you would lose your hearing again."

He said, "Yes, but I found that what I heard is worse than what I drink."

We do welcome you here today. St. Paul is proud to have this National Tax Conference, because of the importance of that question.

There is one thought I would like to leave with you, and I am going to take this up with the United States Conference of Mayors, when we meet, that somebody ought to have a real study of the relationship between the city, the county, the state, and the federal government, in tax matters, in services, a study of the services that each gives, which are the most important, which deserve support, the taxes that each has access to, and study that question all the way through so that some solution can be reached with reference to these important questions.

We are getting into that more and more every day, where the city feels it is being crushed because of the taxes that are being taken out of the city and the small amount that is being returned. Those are questions I think that are most important, and should be studied in the near future.

We welcome you here, and we hope that you enjoy your stay in St. Paul. I have heard a lot about the National Tax Conference, and I am glad that it is here, so that we can get a first-hand glimpse of it and perhaps be educated in some of the problems that will be solved, I hope, at this conference. It is important. Many people are looking to you. Many people are interested in this. I have heard more talk about it than any other conference that has come to St. Paul for a long time, because of the importance of the questions that you are considering.

So, good luck to you. May your deliberations be successful, and may your stay here be enjoyable.

President Maxwell: The National Tax Association has a great deal of talent in it of all kinds. I am going to ask now the gentleman who by common consent will be rated the orator of the National Tax Association to tell you folks and the Honorable Mayor here how glad we are to be here.

Senator Edmonds.

Franklin S. Edmonds (Pennsylvania): Mr. President and Fellow Members of the National Tax Association: I join with you in cordial appreciation of the courteous words of Mayor McDonough in bidding us welcome to St. Paul. I read the census report on St. Paul which was issued a week or two ago about the finances of St. Paul. It starts off by saying that St. Paul has a balanced budget, that it pays all of its debts, has performed all of its services and

had a balance over. I think that is fine, sir. Then I sit here alongside of Commissioner Spaeth, and he tells me of the excellent things that are transpiring with reference to state finance, and I have finally, Mr. President, come to the conclusion that we made a mistake coming here. We always try to go to the community that we can help. I want to suggest that we recess and meet in Washington.

I don't think St. Paul and Minnesota need us at all. I think Washington needs us terribly. It seems to me that ought to be the appropriate thing to do.

But we won't leave St. Paul until we have thoroughly had an opportunity to appreciate what the Mayor's welcome meant. I am sure that I join with all in saying that we expect a most happy conference here, and one of the happy things that we will remember about it has been the hospitality and the graciousness of the people of St. Paul.

President Maxwell: I am going to see if I can't get a word out of Commissioner Spaeth on my right here, tax commissioner of the State of Minnesota.

G. Howard Spaeth (Minnesota): Mr. Chairman and Delegates to the National Tax Conference: I assure you it is a pleasure for me to be here today and appear on behalf of the State of Minnesota and its 87 counties. I am a little bit nervous about the build-up that the Senator gave the conference this morning as to what would be said here this noon. I am not apologizing for the Mayor of the City of St. Paul, but I know that as far as I am concerned I will be without the ability to measure up to the expectations that you may have built up as a result of what the Senator said this morning.

We bid you a most hearty welcome to the North Star State of Minnesota, sometimes called the Gopher State, bounded on the north by the Province of Manitoba, and on the west by the states of North Dakota and South Dakota, and on the south by Iowa, and on the east by Wisconsin and Lake Superior.

You start at Duluth, the largest inland port in the United States, and traverse the region of the pines and the lakes. We boast of over 10,000 lakes in the State of Minnesota. We have had a terrific rainfall, and I think that number today has perhaps been tremendously increased. It runs to the western border of the state, where you find the most fertile fields and the richest soil that any country in the world can boast of, rich in the production of barley, wheat, and corn and oats, to say nothing of beef and pork.

If you run that same line south along the western border of the state and across the southern part of the state, you see a continuance of the rich farming activities.

The northern part of the state is plenteous in game of all kinds. Fishing is unequaled.

We are a state of champions, whether it is in the production of butter or butter fat or whether it is in the building up of football teams, or whether it is in the election of governors. I bid you a most hearty welcome to this North Star State, and hope that while you are in our city you enjoy yourselves and take advantage of the hospitality that we are so willing to offer you. I thank you very much.

PRESIDENT MAXWELL: We appreciate, I am sure, the gracious words of welcome from our good friends.

One of the pleasing experiences in the history of the National Tax Association running back through the years has been the friendly relations and the friendly participation in our association and its proceedings by our Canadian friends. I will not say that the relation between the United States and Canada is one of the outstanding examples of friendly neighbors; I will say it is the outstanding example. It shows after all how little international boundaries should mean.

We are delighted to have attending our conference at this time and our luncheon today Mr. Stuart Garson. He is Finance Minister of Manitoba. He will talk to us about the "Effects of War on the Canadian Provincial Fiscal Systems." Mr. Garson.

MR. STUART GARSON: Mr. Chairman, your Worship, Distinguished Guests, and Gentlemen: May I first of all say how much I appreciate the great honor of addressing you today. You know, Mr. Chairman, I feel entirely at home here. I am not unaccustomed to the American viewpoint, or to American domestic discipline, because my wife is a native of the State of Minnesota. And as an example of that condition to which you referred, sir, that the boundary between our two countries means, after all, very little, the day before yesterday, at Washington, a Canadian cousin of mine was married. Her mother had come from New York to Canada to raise Canadian citizens. She is returning the compliment by going back to North Carolina to raise some American ones.

So that if there is anything in this blood theory that Adolph Hitler speaks so much about, I think we should be upon speaking terms in your country and mine—and, of course, we are, or I would not be here today.

THE EFFECTS OF THE WAR UPON THE CANADIAN PROVINCIAL FISCAL SYSTEMS

HON. STUART S. GARSON, K.C.

Treasurer, Province of Manitoba
Winnipeg, Manitoba

In discussing subjects such as the one assigned to me to-day I prefer to confine myself to a field in which, in slight measure, I am qualified to speak. For this reason I shall deal with the effects of

the war upon the Treasury of which I am the minister. The Treasury of the Province of Manitoba is, in some of the respects under discussion to-day, typical of all of the provincial treasuries of Canada, and is typical certainly in most respects of the three prairie provinces.

For the purpose of our present discussion "The Effects of the War upon the Canadian Provincial Fiscal Systems", at any particular point of time—the present for example—obviously fall into two groups:

1. Those which have already happened, which are facts.
2. Those which we have not yet encountered but which we think we eventually must.

The main effects of the war which have already happened are two. They can be quite simply stated:

1. The absorption of large numbers of the unemployed into the war effort has greatly reduced unemployment relief costs, thereby relieving provincial budgets of a large part of their most onerous burden of the decade just past—viz., unemployment relief expenditures.
2. The huge expenditures upon the war effort by greatly increasing the national income, has stimulated provincial tax collections.

These two effects of the war which have already happened, have reduced greatly provincial relief expenditures, and have increased quite appreciably provincial revenues. They have done this, it would seem, because provincial treasuries have up to the present felt the benefits of war expenditures, but have not yet felt the full impact of the heavy pay-as-we-go federal taxation necessary to support these expenditures. Until now, therefore, the effect of the war on balance has been advantageous to provincial treasuries.

It is self-evident that these effects will not continue as the only effects of the war upon provincial treasuries. Other effects, mainly adverse, may be expected to develop in due course in the war period; and the first World War experience in Manitoba, as in most other provinces and in other countries, was that the most troublesome problems arose in the post-war period rather than in the war period itself.

The effects which we have encountered are facts. The future effects upon provincial treasuries of the war and its aftermath are merely our theories as to what will happen hereafter. They can be divided into two groups:

1. Those which we shall encounter during the war itself.
2. Post-war effects.

Fortunately for me . . . and for you . . . I shall not have time to-day to indulge in the orgy of prophecy which would be needed to

produce even the hypotheses for one's theorizing as to what the post-war effects upon our provincial public finance will be. For the remainder of my time, therefore, I shall deal with the future effects of the war upon the provincial fiscal systems of Canada, during the period of the conflict itself.

In order that my remarks in this connection may not be more confusing than helpful to those of you who are not familiar with the Canadian constitution I should here make a note of one or two constitutional points.

When the Dominion of Canada was formed, nearly 75 years ago in July 1867, the functions of government assigned to the provinces included administration of justice, education, road building and maintenance, municipal organization, charities, property and civil rights, etc. These functions were then not costly, and the financial plan of confederation was based upon the assumption that they would not become costly. Hence the provinces were given only the limited field of direct taxation. According to the Hon. A. T. Galt, one of the chief architects of the financial plan of Confederation if the provinces " increase their expenses in proportion to the growth of population they will be obliged to resort to direct taxation; and he thought they might trust the people themselves to keep a sharp watch over the local governments lest they should resort to direct taxation."

The dominion government with what were then thought to be the more costly functions to perform, was given the right to impose any kind of taxation, direct or indirect. But while in theory the dominion taxation field was unlimited, in practice it was limited by the fact that it could only exercise its right to impose direct taxation by invading the one field assigned to the provinces. It was not until 1917, half a century after Confederation, and three years after the commencement of the first World War at a time when the Dominion's need for increased revenues had been extremely and increasingly urgent for over two years, that the dominion government imposed direct taxation for the first time, by the War Income Tax Act of that year. Even in the face of this urgent need dominion income taxes were begun, and until the outbreak of the present war, have continued on a relatively modest scale.

The practical effect of limiting the provinces to direct taxation which in the main is progressive taxation, has been in very large measure and certainly unduly to limit the Dominion to indirect taxation which in the main is regressive. Moreover, by this now out-of-date constitutional division of the fields of taxation in Canada, the dominion government has been greatly limited in its use of two of the most efficient instruments in a modern federal state for redistributing the wealth and income which accumulates in certain provincial jurisdictions:—viz., income taxes and inheritance taxes.

One of the results has been that the cost to the dominion treasury of the World War of 1914-1918, of servicing the war debt, and of the great post war depressions, has been met to an inordinate extent from regressive taxation. For example, in 1930 the revenues of all governments in Canada — federal, provincial and municipal — were obtained from the following taxes:

From taxes which fluctuated more widely than national income		
Customs duties	about	20%
Taxes on cigarettes and liquor	over	10%
Amusement taxes, public domain, etc. taxes		5%
		35%
From municipal taxes on real estate	about	33%
From corporation taxes, gas taxes, sales taxes, licenses	slightly over	25%
From progressive taxes on personal incomes and inheritances	less than	7% [1]

Clearly this was an exceedingly ill-balanced tax structure. Yet during the depression which followed 1930 we find this condition aggravated. The provinces were then caught between heavy and increasing responsibilities for unemployment relief on the one hand, and declining provincial revenues, on the other. They needed every tax source which the constitution gave them, and they needed it unimpaired by dominion invasion. The Dominion in respecting the predicament in which the provinces found themselves, was forced to meet its own situation caused by rising federal relief expenditures and decreasing collections from existing federal taxes, in the following manner. I am quoting from the *Sirois Report*, Book 1, page 176.

> "In its efforts to raise additional income the Dominion resorted mainly to increases in consumption and corporation taxes. The progressive tax field was either left to the provinces, as in the case of the succession duties, or was not aggressively utilized. The sales tax was successively advanced from 1% to 8%. Corporation, income taxes, excise duties on liquors and tobacco and revenue customs duties on a number of items of general consumption were sharply raised. Personal income tax rates were increased and exemptions lowered but not sufficiently to take care of more than a small part of the total requirement. Between 1930 and 1937 total Dominion revenues rose from 314 million to 464 million; almost three-fourths of this increase was produced by the sales tax. . . . The joint occupation by the Dominion and the provinces of the progressive tax field (except inheritance taxes) and the corporation tax field led in the one

[1] *Sirois Report*, Book 1, p. 175, and Table 73, page 177, *idem.*

case to inadequate use and in the other to wasteful duplication. As a consequence far too great a proportion of the load of government expenditure was carried by regressive consumption taxes, by real estate taxes and by economically harmful taxes on corporations and business."

Before this audience I do not need to dwell on the defects of this tax structure. Of particular interest to us in Manitoba as an agricultural exporting area were the following facts. This tax structure inflicted heavy burdens upon the primary producer selling his products for export, upon the poor, and the consumer. It aggravated the maladjustments which were perpetuating the depression. It tended to make poorer the low-income groups in every province and the treasuries of the provinces in which these groups predominated. At the same time by leaving inheritance taxes wholly and income taxes largely to the provinces, it fertilized the revenues of the wealthier provinces. And because these wealthier provinces with their larger taxable resources did not need to impose as high rates of provincial income tax as the poorer provinces were forced to do, it left wealthy persons in wealthy provinces under a relatively light burden of income taxation.

Yet, under the division of the fields of taxation presently made by our constitution, the only way in which the Dominion could get more of its revenues from progressive taxation and less from regressive taxation, was by invading the provincial field of direct taxation and thereby drying up provincial sources of revenue at a time when several of the provinces needed every cent of revenue they could get. Except that the depression had made it more critical, there was nothing new in this situation. For at least a quarter of a century the dilemma of the dominion Minister of Finance has been to choose between an undue reliance on regressive indirect taxation, upon the one hand, and an invasion of the provincial field of direct taxation with adverse effects upon certain of the more vulnerable provinces, upon the other.

This situation was bad enough in the last war, the costs of which in any one year rose scarcely above 10% of the national income. In the present conflict when it is altogether probable that Canada's war expenditures will exceed 50% of the national income, such a tax structure is quite intolerable. Thus within a few days after the outbreak of this war the dominion government was forced, regardless one might almost say of the consequences to provincial public finance, to impose heavy increases in federal income taxes and an excess profits tax. Both of these have since been steeply increased. Our excess profits tax, for example, is now quite as heavy as that of Great Britain herself. For the first time the Dominion has imposed a federal inheritance tax. And the end is not yet.

These taxes naturally had the effect of drying up provincial revenue sources. From the income tax payer's standpoint, superimposed as they had to be upon provincial and municipal taxation of varying levels throughout Canada, these new dominion war income taxes produced aggregate rates of combined dominion and provincial income taxes that in certain cases were nothing less than fantastic.

The dominion government of course fully realized the probable effects of these new federal taxes upon the provincial treasuries, particularly upon the more vulnerable of them. Hence in his Budget Speech of April 29th, 1941 the dominion Minister of Finance, the Hon. J. L. Ilsley, made the following proposal to the provinces. I quote his own words, as follows:

> ". . . the dominion will offer to pay each year for the duration of the war to any province, which together with its municipalities, will temporarily vacate the personal income tax and corporation tax fields either
>
> (a) the revenues which the province and its municipalities actually obtained from these sources during the fiscal year ending nearest to December 31st, 1940;
>
> or,
>
> (b) The cost of the net debt service actually paid by the province during the fiscal year ending nearest to December 31st, 1941 (not including contributions to sinking funds) less the revenue obtained from succession duties during that period
>
> . . . . . .
>
> to guarantee to them an amount equivalent to the revenue which such provinces actually receive from gasoline taxes during the fiscal year ending nearest to December 31st, 1940, providing they do not change their present gasoline tax rates
>
> . . . . . .
>
> Such payments will be augmented by appropriate fiscal need subsidies where it can be shown that these are necessary.
>
> . . . . . .
>
> the arrangements with the provinces will be discontinued within one complete year after the war. . . ."

Less than three weeks ago the Minister of Finance for Canada convened a meeting of provincial treasurers at Ottawa for the purpose of settling the terms of written agreements between the Dominion and the provinces bringing into effect the above-mentioned proposals of his budget speech. Because provincial elections were

impending in British Columbia and Nova Scotia, the governments of these two provinces could not with propriety until after these elections reach any final agreement with the Dominion. With the other provinces, however, progress was made; and it is reasonable to expect that agreements with most of them will be completed before the end of this year. These agreements, if and when consummated, will be themselves some of the major effects of the war upon our fiscal systems.

In what position would such an agreement leave Manitoba?

The answer to this question turns upon the adequacy of the Dominion fiscal need subsidy. Fiscal need is something which, particularly in war time, will vary from year to year in an unpredictable manner and by unpredictable amounts. Provinces requiring subsidies would therefore prefer to have them set at the end of each fiscal year upon the basis of the then known need of that year. This practice, however, would involve the dominion government in the supervision of provincial budgets—a task which is distasteful enough in peace time but particularly difficult in war when the dominion government has its hands full with the national war effort. One can expect the Dominion to take the position that once the amount of the fiscal need subsidy is fixed, it must remain fixed for the duration, and that it is the province's problem to live within its means, inclusive of this fixed subsidy. But is this possible? I think not, unless, of course, the Dominion were to fix the subsidy with a margin over and above our present fiscal need sufficiently wide to take care of the unpredictable future needs which accrue during the term of the agreement. If the Dominion refuses to allow such a margin, what is our position? The fixed fiscal need subsidy, together with other relatively constant items, constitute slightly over two-thirds of our total revenues. Not quite half of the remaining third of our revenues which are variable, is made up of automobile licenses and profits from the provincial state liquor monopoly. So far these have held up remarkably well; but they could be rapidly pulled down by rationing, heavy federal taxation and other wartime policies of the dominion government. The remaining variable revenues are in much the same position. Therefore, the best we could hope for is that our total revenues would be constant.

But what of our expenditures? Can they, even by the most stringent economies, be fixed? In this regard, our position in Manitoba is that we had the misfortune to enter the war before we completely emerged from the depression. Having made drastic cuts in our expenditures during the depression, which had only been partially restored by September, 1939, our scope for economies is now limited by this fact. For example, we cannot economize to any substantial extent in the maintenance of our capital investment in buildings, roads and bridges, because during the depression we have already economized on these almost to the point of capital depreciation.

Again, our unemployment relief costs are now declining. Indeed, of economies now available to us, unemployment relief economies are much the most, if not the only, substantial ones likely to be available to us. But presumably cognizance of this fact will be taken in fixing the amount of our fiscal need subsidy. Therefore, to make available funds wherewith to meet unforeseen expenditures during this war, we can only count upon economies in unemployment relief to the extent that allowance for these same economies has not already been made in fixing our fiscal needs subsidy.

On the other hand, owing to the rising cost of living and of doing business we face inevitable increases in the cost of maintaining our capital investment in buildings, roads, bridges, etc., of operating our public institutions and of meeting Civil Service payrolls.

Obviously, therefore, if the Dominion insists upon the fiscal need subsidy being an amount fixed for the duration of our agreement and refuses to make any allowance for a margin over and above our present needs to take care of unpredictable future needs, our ability to keep our budget in balance will depend upon two things:

1. The success of the dominion government's efforts to prevent inflation.

2. That the strain and dislocations of war will not create for us unpredictable future needs which cannot be met out of the proceeds of minor economies.

If any substantial measure of inflation supervenes, if the strain and dislocations of war create for us large future expenditures not now foreseen, then it is perfectly apparent that the economies which still remain available to us on even the most drastic basis will certainly be insufficient to offset our rising costs and our necessary but now unforeseen future expenditures. For such a situation, if it arises, the only solution will be a re-examination of our agreement with the Dominion with a view to an increase in the Dominion fiscal need subsidy.

President Maxwell: I am sure we appreciate Mr. Garson's attendance at this conference, and his very enlightening contribution made to it. That is sort of a left-handed consolation, knowing that other jurisdictions have their fiscal difficulties, as well as our own.

That completes our program for this session.

Nothing further appearing, and without objection, we stand adjourned.

(The meeting thereupon adjourned, at two o'clock p. m.).

THIRD SESSION

MONDAY, OCTOBER 13, 2:30 P. M.

Spanish Room, Lowry Hotel

ROUND TABLE CONFERENCE

John A. Scott, presiding.

CHAIRMAN SCOTT: Thirty-one years ago last month, I was appointed assessor of the City of Duluth. Looking back to those days, it seems almost incredible how little attention was given to the matter of assessing real estate in a city with a population of 80,000 and with an assessed value of forty million dollars. There were no records of sales, nor information of any kind to be used as a guide in preparing the forthcoming assessment. Many former city assessors were political appointees, giving practically no time or attention to the job, and leaving the more important phases of the work in the hands of a deputy whose principal duty was copying the assessments of the previous year.

In 1907, the state legislature provided for a three-man board known as the Minnesota Tax Commission, which was organized in 1908, with Judge O. M. Hall, Samuel Lord, and Frank L. McVey as the original members. J. G. Armson of Stillwater was appointed to the commission in 1909, to fill the vacancy caused by the retirement of Mr. McVey. So, it has been my privilege to work under every member of the commission except one, from the time of its organization down to the present day. The importance of the work done by the commission in its early days cannot be over-estimated. Mr. Lord served up to the time of his death in 1925, and Mr. Armson for a period of twenty-four years.

All of the older members of this association were well acquainted with both of these last two gentlemen, as they were regular attendants at every conference, and took an active part in making them a success.

The commission continued to function as a three-member board until two years ago when the State Reorganization Act was passed, placing the entire tax system of the state under one head, known as the commissioner of taxation, who is appointed by the governor.

The first commissioner is Mr. G. Howard Spaeth, who has shown remarkable ability as an organizer and who is conducting the state department of taxation on a business efficiency basis. I have found Mr. Spaeth a very pleasant and agreeable state official to work with.

The National Association of Assessing Officers, realizing the tremendous importance of the assessing problem, in 1937, appointed a committee to make a study of assessment organization and personnel. This committee has just completed this work and the results are set forth in a volume containing over four hundred pages. I am quite confident that within a short time this study of administrative practices in the assessment field will have taken its place as one of the foremost contributions in the field of literature in public administration.

The committee was fortunate in its choice of a chairman, who has been a most enthusiastic and untiring worker over a very long period. He was chairman of the Kentucky Tax Commission, and more recently, Director of the Bureau of Business Research, of the University of Kentucky. He is Dr. James W. Martin, and the meeting this afternoon is given over to the consideration of the headlines of this report, and Dr. Martin will treat the subject under "The Approach to State Supervision."

THE APPROACH TO STATE SUPERVISION

JAMES W. MARTIN
Director, Bureau of Business Research
University of Kentucky

Two primary introductory issues should be presented in these opening remarks. In the first place, it seems proper to outline the "approach" to the administration of property assessment supervision. Some would refer to this part of the discussion as a statement of *supervisory policy*. In the second place, it may be appropriate to outline briefly the various phases of state supervision and to state a definite hypothesis with respect to wise policy. Whatever is said in this second connection will be in the main a rehash—if not a direct appropriation—of the views of the National Association of Assessing Officers as developed in the report of the Committee on Assessment Organization and Personnel and approved last year by the assessors' annual conference.[1]

THE TAX DEPARTMENT'S SUPERVISORY POLICY

In the early days of state tax department supervision of local assessments considerable stress was placed on the viewpoint that the state office should have and exercise extensive *authority*. The recommended plans almost invariably included provision for review and equalization and, in addition, authority to order and make local reassessments, authority to assess omitted property, authority to institute removal proceedings against an assessor, and authority to

[1] *Assessment Organization and Personnel*, pp. 3 ff.

enforce certain penalties. In addition, it was customary to provide in these proposals that state supervisory offices should give advice, call and conduct meetings of tax assessors, require reports, visit local assessors, issue rules and regulations, and prescribe forms. Experience has abundantly demonstrated that extensive authority and effective supervision do not necessarily, or perhaps even normally, go together. As a matter of actual practice, the exercise of the harsher types of supervisory functions has generally been neglected and perhaps properly so in the light of existing circumstances. It is believed [2] that in any event such extreme procedures as removal from office and the ordering of reassessments whether by state or local officers should be undertaken only in exceptional cases and ordinarily only when the locality concerned believes the remedy to be justified.

The approach to the development of a supervisory policy in any of the states, including a goodly proportion of those which do excellent jobs, is predicated on the attempt to become a helpful advisor rather than a powerful boss. It is the consensus of assessment officers generally [3] that this approach is eminently sound.

The general viewpoint as to state supervision of financial activities ought perhaps to be that of providing as much technical and other assistance as possible but consistently trying to secure policy decisions from appropriate local officials. In the case of assessment supervision, if this approach is adhered to, the state department will give advice and provide continuous aid through local field representatives, call and conduct meetings for training assessing officers, make and require reports, pay official visits to the localities as far as possible, prescribe appropriate forms of all sorts, construe or secure a construction of the tax laws, and issue general rules and regulations to afford assessors interpretations and applications of the tax laws to particular cases. Although the state tax department need by no means avoid taking the initiative, it will place emphasis on providing these several varieties of services and assistance and on aiding localities in their efforts to procure appropriate equipment where the localities themselves are definitely interested and are willing to become active.

GENERAL SUPERVISION

In general terms one may conceive the assessment supervision task broadly as lying in three areas. The first class of activities involves provision of aids to local assessors and, if necessary, of the application of the more drastic enforcement measures. The second class concerns the equalization of assessments, which the National

[2] *Ibid.*, p. 29.

[3] *Ibid.*, pp. 28 and 29.

Association of Assessing Officers conceives as including uniform changes in the valuation of all the property of a taxing district or all of a particular class of property in all of such a district. In the third place, supervision, broadly construed, includes the review of local assessments in those instances in which a state agency is authorized to make changes in the findings of local tax machinery.

In the discussion provided by specialists on this program these various items of subject matter will be developed rather fully. Since the speakers in considerable part will draw their subject matter from the experience of particular states, it may be worth while to make some statement now with respect to general practice throughout the country.

With respect to the narrower conception of supervision which would exclude equalization and review it is of interest that such activity is exercised on both a local and a state basis. Some of the counties undertake to provide a measure of supervision for local assessors on a township or other basis, and many cities provide some means of supervising the assessment work. The most usual means is either supervision by the chief executive of the city directly or supervision by a director of finance in whose office are integrated not only the assessment but certain other finance functions. Such local supervision is irrelevant to the present inquiry. It appears that as to the second type of supervision 46 state tax departments provide by law for considerable supervisory activity and that *on paper* a large proportion of these do a thoroughgoing job. *In practice*, however, vigorous state assessment supervision is found in only about a dozen states.

As has previously been suggested, it is believed that most supervisory work by a state tax department ought to be of an educational character, including responses to individual inquiries, organization and conduct of assessment conferences, development and use of assessment manuals, promulgation of rules and regulations which give specific interpretations and applications of the tax laws, and provision of field supervisors who, among other things, will make actual assessment demonstrations and clear-cut efforts to assist all local assessing officials through every means possible. It is particularly important that a plan of circulating information letters be developed, so that assessors can be promptly and uniformly advised of new legislation, new rulings of the attorney general, and new court decisions materially affecting their work.

EQUALIZATION OF ASSESSMENTS

The supervisory practice facetiously referred to as "equalization of assessments" is among the older techniques of general oversight and is frequently confused with review.

"Equalization is the process by which an agency increases or decreases by a uniform percentage the assessed valuation of all property, or all property of a particular class, within a single tax or assessment district. It is intended to serve various purposes: (1) to bring the average assessment ratios of two or more tax or assessment districts to a common level before the imposition of a tax intended to bear uniformly upon all districts; (2) to bring such average ratios to a common level before the distribution of funds to tax districts according to a formula involving assessed valuations; (3) to bring the average assessment ratios for state-assessed property and locally-assessed property to a common level when both are subject to the same or related tax rates; (4) to make tax levy and debt limitations based on assessed valuations effective by equalizing the average assessment ratio and the legal ratio; and (5) to bring the average assessment ratios for various classes of property to a common level before imposition of a tax intended to bear uniformly on all classes." [4]

As a means of securing good assessment, equalization activities are quite usual among the 39 states which assign this function to a state agency. Of these 26 may alter valuations by classes of property and 24 by minor tax or other districts as well as by counties. In the opinion of most tax authorities equalization activity is entirely appropriate, but in all probability it is too much utilized in a considerable number of states. If the state government gave assessors adequate means of doing their work including reasonable provision for tax department assistance, it is probable that the need for equalization could be greatly reduced. Certainly there are serious objections to equalization proceedings when some other technique of unifying assessment levels is available. An illustration which has frequently been suggested involves two equally valuable properties worth, say, $10,000—one of them assessed at $10,000 and the other at $5,000. An equalization order requiring a 10 per cent increase in all of the assessments of the particular county or subordinate taxing district to bring the average to an appropriate level would mean a $1000 raise in the already properly assessed parcel and only a $500 raise in the parcel already under-assessed 50 per cent. In the light of this consequence of the equalization process, which appears to be inevitably pervasive, it is believed that, necessary as such a procedure may be, it should be regarded as by no means a satisfactory substitute for good original assessments.

[4] *Ibid.*, pp. 24-25.

THE REVIEW FUNCTION

The review of property assessments involves the right on the part of the reviewing agency to change individual valuations when it becomes apparent that they have been made erroneously. The consensus among assessment personnel is that there should ordinarily be a local review agency and also at the state level a second agency to whom appeals from local review agencies would lie. In general, this means that the state tax department either directly or otherwise should make available means of hearing and deciding finally (so far as the administrative branch of government is concerned) the matter of individual assessment levels. It is believed, too, that all these administrative review proceedings should be prerequisite to any appeal to the courts. That is, no taxpayer should be afforded an opportunity to apply for judicial review unless he has already exhausted available administrative remedies.

As practice now stands, about 26 states provide for review of local assessments. In nearly all these instances there is also a local review. In some of these states review is effected by the state tax department itself, and in others independent review agencies, usually called boards of tax appeals, are provided.

Our program today provides for definite discussion of review agencies as such because of the recent development of boards of tax appeals, authorized in some cases to review local assessments. In general, these boards are set up on two plans. The most usual provides for three or more members who may act individually or may act as a board on particular reviews. In some cases, as in the instance of the federal Board of Tax Appeals, members of the board make decisions which ordinarily are not studied by other members. In some cases the decisions, however, are findings of the board as such. In view of the satisfaction which has arisen from reviews by board members rather than by boards as such, the experiment of providing a single member review agency as in the District of Columbia is of peculiar interest and will be particularly discussed on this program. Certain students of the problem believe that a one-member review agency is definitely to be desired for reasons of economy and of simplicity unless the volume of work is such that two or more individuals are required to handle it.

The program which has been organized for this afternoon's round table provides for one or more papers on each of the principal classes of supervisory techniques. In turn, these papers will examine aids to local assessors, the equalization of assessments, and the review of individual assessments. This discussion will be supplemented by particular consideration of the work of boards of tax appeals independent of state tax departments.

CHAIRMAN SCOTT: Mr. George W. Mitchell became Director of Research of the Illinois Tax Commission when Simeon E. Leland was Chairman. Upon Mr. Leland's resignation early in 1940, Mr. Mitchell became a member of the tax commission. In March of this year, the governor appointed three new members to the tax commission and since that time, Mr. Mitchell has been serving again as Director of Research. He is particularly qualified from his experience to speak on "Aids to Local Assessors."

AIDS TO LOCAL ASSESSORS—STATE OFFICE VIEW

GEORGE W. MITCHELL

Director of Research, Illinois Tax Commission

The scope of state aid to local assessors depends chiefly on the relative calibre and resources of the state administrative agency and the local assessors. The range of activity is greatest in states having a well-staffed and technically equipped central office working with hundreds of part-time local assessors. It is at a minimum where the state office is poorly equipped or the local assessment officials are full-time officers with jurisdictional areas large enough to warrant specialization in appraisal techniques and assessment procedures. In Illinois, for example, the aids provided by the Tax Commission are primarily for the benefit of downstate counties, most of which have part-time township assessors. The Cook County assessor's office is large enough to create within its own organization the specialization required to deal with virtually every assessment problem. Even for such areas, however, a good state tax commission with vigorous leadership can influence and direct policies into channels which lead to statewide uniformity.

Assuming a state office with average personnel and equipment and township or typical county assessors, there is a natural division of functions between these official bodies. The aspects of property tax administration that can be regarded as overhead activities are most fittingly performed by the state agency, as, for example, preparation of records, forms, and assessment manuals, the drafting of legal opinions, the interpretation and application of statutory requirements, and the convening of regional or statewide groups of assessment officials. To the local assessors is left the application of these general rules and their modification to meet local situations. My views as to the scope and character of state assistance can be pretty well summarized by reference to the Illinois program. The commission prepares assessment records of all types: taxpayer schedules, assessment blanks, and various forms incidental to assessment administration. These are invariably accompanied by instructions as to their proper use. No form or record is entirely self-

explanatory; if uniformity in procedure matters, illustration and directions are essential. An attempt to attain uniformity for uniformity's sake sometimes places the state office in an absurd position, for real variations in local situations call for varying treatment. The state office must be in possession of enough pertinent facts to tell when departures from a prescribed form should be allowed. Local officials are prone to regard their problems as unique and expect numerous modifications to meet personal preferences and idiosyncrasies. All forms of consequence prescribed by our commission are devised with the assistance of an advisory committee of local officials.

The commission has prepared numerous assessment manuals and reprints of the tax laws for the use of local officers. These manuals are written with a view to providing a readable document but are primarily intended to be a handy reference book to all legal and procedural problems ordinarily encountered by local assessors. They contain detailed indexes, reproductions of assessment forms, numerous illustrations and diagrams, tables, etc.[1] We have found through successive editions of this manual (there have been four since 1933) that it has been possible to anticipate 90 percent of the questions raised by assessors. The answer is not always complete in every detail, but enough pertinent comment and sufficient documentation is provided to satisfy most taxpayers or assessors. Questions that are out of the ordinary are handled by personal correspondence or interview; if they seem of sufficient general interest they are covered by mailings of mimeographed material to the supervisors of assessment. These releases are incorporated into the subsequent editions of the manual itself. In my opinion, a comprehensive, well-written assessment manual is the best single aid the state office can give to local assessment officers. It is a tool which is always available to the assessor and in no sense constitutes a usurpation of his dignity or authority.

In addition to the *Assessors' Manual* we have a Board of Review manual which is devoted primarily to the discussion of equalization, and review and exemption problems of Boards of Review.[2] There is also a manual on tax rate limits and tax extension procedure primarily for the use of county clerks and levying authorities of the various taxing districts. This is issued biennially after sessions of the General Assembly.[3] The commission has in preparation a real estate assessment manual which is intended to provide a detailed guide to the appraisal of urban and rural property. This manual is

[1] *Illinois Assessors' Manual—1939.*

[2] *Illinois Board of Review Manual.*

[3] This series is summarized in *Survey of Local Finance in Illinois,* vol. VIII, "Tax-Rate Limits and Assessment Ratios: 1925-1940," pp. 45-93.

flexible enough to permit its adaptation to the conditions of any county in the state. It is being developed along conventional lines excepting for the sections dealing with rural land appraisal and a conversion formula to adjust reproduction costs to fit conditions in various sections of the state. The manual sets forth typical or modal prices on a statewide basis; the conversion formula takes care of those areas where prices differ materially from the average state price. Complete reliance cannot be placed upon this formula, and wherever the system is adopted on a county basis it is our intention to carefully re-check and to re-work the cost figures in line with conditions in that particular area. It has been entirely practicable to adopt a uniform classification of improvements on both urban and rural property throughout the state, and it is also expected that the urban land rules can be standardized.

The technique for appraising rural land for tax purposes has not been as well developed or widely used as that for urban property. Our approach to this problem is tentative and subject to change after we have had an opportunity to test it out. In its present form the procedure contemplates using productivity of the soil with proper allowances for slope and erosion as the basic factor in valuation. Provision is made for the adjustment of these values to take into account the proximity to all-weather roads, urban areas, trading centers, and other factors of location, to the state of cultivation, fencing, terracing, plantings, etc. In Illinois there are soil maps of a sort for every county in the state. For one-third of the counties these maps are up to date and thoroughly reliable for the purpose at hand; in the other two-thirds of the counties the maps are older but still afford a reasonably good guide in this approach. The very large volume of rural land appraising undertaken during the depression for the land banks and insurance companies has advanced the technique of farm land appraisal, but the appraisals for loan purposes are typically performed by better trained and more experienced appraisers than are available in the assessment organization of our state. These government and private appraisers, despite the elaborate data sheets which they prepare, place very heavy reliance upon their judgment, and it is doubtful that it would be feasible to develop a standardized appraisal system along those lines. Furthermore, appraisal for credit purposes has a fundamentally different approach than that for tax purposes, and it is difficult to adjust one to serve the other purpose.

This manual and the plan of action which is being developed in connection with it is the most ambitious undertaking in our program of supervision of local assessment officers. At the present time only one county, Cook, in which Chicago is located, has a standardized appraisal system. St. Clair, a county in the metropolitan territory east of St. Louis, is in process of installing one, and a few urban townships have made some beginnings along this line.

There are other aids to local officers that can be best implemented by the use of manuals. We contemplate the preparation of one dealing with property tax collection law and procedure. Another has been developed on the organization of ownership and legal description records and property maps. The latter is in use on a state WPA project with operation in one half of the counties of the state under the supervision of the tax commission. This, incidentally, is another avenue of state aid which was important when the WPA program was in full operation. A state office equipped to sponsor and supervise WPA projects dealing with assessment and property tax records can undertake aids that are impossible under the typical budget of a supervisory agency.

Another essential phase of the state office work is the employment of field supervisors who are in constant touch with local assessment officers and are available to them for assistance of all kinds. Such a staff serves as a link between the state agency itself and the local officials. It is just as important that the state officials should be well acquainted with local problems through direct and intimate contact with them as local officials should be familiar with the rulings and recommendations of the state office. The field staff in Illinois is not developed to as great a degree as is desirable. This is probably due in some measure to the fact that the state no longer levies a property tax; hence, has only indirect interest in its administration, but our field staff has been quite effective in appraising the commission of the point of view of local officials and has been securing their cooperation for many of the activities of the office.

If the state agency has occasion to make original assessments, as of railroads and public utilities, it can perform invaluable service to assessors in smaller jurisdictions by assisting them with the assessment of large corporate holdings. Few assessors have an opportunity to develop any experience in assessing this type of property, and, as a result, their efforts are usually of lower caliber than their assessment of typical rural and urban real estate. A state commission with experienced appraisers, engineers, and accountants, can be of very considerable help to local assessment officers on this front.

Some states provide for the reassessment of individual properties on the initiative of the state administrative agency itself. In Illinois, however, no such power is given to the commission and our assistance to local officials is on their request only. It is highly important that if the supervisory agency is going to work effectively with a large number of local assessors that it must at all times have the good will of a majority of them. Without an elaborate system of policing, no state agency could effectively promote a program of improving assessments without the cooperation of local officials.[4] This

[4] Two forms of policing are equalization and reassessment orders. The Illinois Commission has power to equalize assessments for purposes of a State tax, but as there has been no State levy since 1932 this power has not

does not mean that the state office needs to accede to the demands of every local official but only that its policy receive substantial approval by the majority of them.

Finally, the commission has done much to encourage and unify assessment policies throughout the state by holding frequent meetings of local assessment officers and thus affording an interchange of ideas, expressions of opinion, and, at the same time providing for definite and concrete suggestions on particular problems. Illinois has held such meetings for the past several years and has encouraged similar gatherings by associations of local assessment officers.

With the completion of our real estate appraisal manual this next year, we expect to start the installation of systems throughout the counties of the state. Several have already expressed an interest in this program and have indicated their willingness to appropriate the necessary funds. The commission will presumably furnish some overhead assistance in getting these projects under way and will work closely with local assessment officers throughout the time that the work is in progress. This program should be of lasting benefit to the taxpayer and the governments. Illinois' progress in improving local assessments has been slow, but I think it has been relatively steady. If it continues at the same rate for another decade I believe that the state will rank high in its property tax administration. What improvement has been effected to date has not been by legislation but by working as closely as possible with local officials by attempting to understand their problems and points of view. Spectacular progress is usually accompanied by sweeping statutory changes, but there is much to be said for working within the existing statutory framework. Frequently the same ends can be achieved, and, if this is possible, the confusion arising from dislocation of the administrative organization is avoided.

been exercised. Parenthetically, while the need for equalization was very real prior to 1932, there were few years in which any equalization took place. In years when equalization took place, it is impossible to determine the information and facts upon which the commission acted. Its efforts appear not to have increased the equity with which State taxes were levied. Neither has the Illinois Commission been active in ordering reassessments. During the past several years some six or eight petitions for reassessment have been filed with the commission, and, with one or two exceptions, these have been denied. The commission has used its good offices to get the local assessing officers without compulsion of a formal order to make adjustments in the direction of the improvement of local assessment. It has been the feeling of the commission that reassessments without the guide provided by standardized appraisal offer little in lasting or real improvement in local assessment conditions and, further, that the damage done to the relationships between the commission and the local officials and taxpayers far exceed the benefits which might accrue from the equalized assessment. In Illinois the county tax rate is a relatively small proportion of the total rate. The school districts are small and the majority of them do not even cross a township line. The re-allocation of tax dollars by virtue of an equalization between townships or as between urban and rural property is seldom large enough to warrant a reassessment order.

Chairman Scott: Mr. Roman C. Herman is city assessor of Manitowoc, Wisconsin. He is active in N.A.A.C. work, and is the Wisconsin state chairman of the organization. He is an extremely able and progressive assessor, and will present the "Aids to Local Assessor from the Viewpoint of the Local Assessor," a theme in which we are all interested.

AID TO LOCAL ASSESSORS FROM THE VIEWPOINT OF A LOCAL ASSESSOR

R. C. HERMAN

Assessor, Manitowoc, Wisconsin

[Mr. Herman first reviewed the part of property taxes in the Wisconsin scheme of things, traced the development of uniform assessments, and discussed the assessment legislation of Wisconsin. He then went on to recommend the adoption of certain procedures.—Ed.]

The Department of Taxation should institute the following procedures uniformly throughout the state, some of which have been past or present practices and some of which are not uniformly applied:

1. *To provide an assessors' manual* of such scope and magnitude as to provide all local assessors with the necessary technical and theoretical information needed to assess all like and similar taxable property. Such a manual should serve at least two purposes: first, to explain and illustrate those problems commonly met in the appraisal of land and buildings; and second, to be a handbook for the use in the valuation of urban and other properties, where cost of reproduction less depreciation is the common basis of estimation. It should certainly serve as a guide to the systematization of an orderly procedure on the part and work of assessors which requires a great deal of consistency.

The fundamental requirement of an assessment roll is that it distribute equitably the burden of taxes, and to do this, the human equation must be eliminated as much as possible. For the individuality of the assessor and his varying judgment, there must be substituted a system of mechanical precision, and supplemented by individual judgment only when necessitated by unusual conditions. The value of an individual parcel is, of course, subject to the tests of income and sale, and under our Wisconsin law must be assessed at a fair sales value. Fundamentally, however, rental and sales values depend upon cost less depreciation, physical and obsolescent.

Sales and rental values are not always available for each and every property, as some properties are not readily salable and some rarely if ever sold. If this information was available for each and every property, cost of reproduction less depreciation must be used

as a base, to insure uniformity, and resorting to sale and rental only to determine his unit values and for conformation of his conclusions as to depreciation.

It is true that Wisconsin has had two issues of an assessors' manual, neither of which have been complete in the thoughts expressed above. These issues have been more of a descriptive or theoretical nature, and tell an assessor what he should know and do, but not how to do it. These manuals interpret the state laws, and describe only a method of land valuation as a technical addition. No mention is made of construction costs for the several types of real estate improvements, which represents the bulk of the assessment roll. Real estate improvements represent more than 75% of the total values of the real estate assessment roll, yet no mention of a yardstick is made to help insure uniformity in conjunction with the remaining 25%.

2. *Supervisory staff* of sufficient size to be able to aid all local assessors upon a reasonable call. It was felt by all local assessors that, prior to the reorganization in 1939, the old tax commission did not then provide sufficient help, and that now, with still smaller forces, this help is lacking to a greater degree. Whether or not all of the supervisors under the old system were qualified, or did uniform work, is not questioned, but it was felt that more qualified supervisors were needed to provide better equalized values, as well as to aid local assessors in their problems. If the districts are to remain as large as they now are, I feel that it is still more evident to provide a larger staff to fairly supervise these districts. The old arrangement of smaller districts did have its advantages, in that it provided closer contacts as well as convenience for the assessor and supervisor alike in accessibility of the district office to the district as a whole. It is entirely possible that the present setup would be sufficient if a county system of assessment prevailed, wherein one assessor with sufficient deputies handled the entire county assessment, or for the purposes of economy in district offices or uniformity of work in the tax department's duties, this setup would be sufficient, provided proper technical help is available. This point is further stressed in times like these, when nearly all local assessors are encountering new problems in defense industry and defense industry communities.

3. *To conduct annual assessors' schools* in addition to the prescribed spring meetings. Such schools are now and have been conducted by the local assessors' section of the League of Wisconsin Municipalities, wherein particular problems were discussed. Under the old program, the supervisors held a joint meeting, to the mutual benefit of both. Since the reorganization, the joint meetings have been discontinued, but it is hoped that this can again be revived. Such a procedure provides definite information for the local assessor

as well as the supervisor, and also develops practices of administration and suggested changes in the statutes. A great deal more can be accomplished in open discussion by a group than can be had in individual conference.

4. *Annual spring meetings* now and have been a procedure of the department of taxation. These meetings tend to familiarize the new assessors with assessment procedures. New statutes are discussed as well as other duties of the local assessor. To some degree uniformity of assessment is obtained only insofar as the city assessor is willing to adopt rural prices on cattle and the like, but no city procedure is ever adopted by the rural assessor. These meetings are one-day sessions, which is much too short a time to cover the field of assessment. More time should be given to these meetings, as they do tend to equalize rural procedures, and joint district meetings have always been found to be beneficial. County lines should never establish real and commodity prices. These meetings occasionally shame some assessors into doing better work through mutual friendships and discussions. Some will never improve.

5. *The department of taxation to furnish sales information* to the local assessors to avoid duplication of effort. At the present time, the department secures this information through a sales letter to the seller or buyer, and uses this information in the fielding of sales. This information is forwarded to the local assessor, who desires it, and is the only available information, since the deed does not always disclose the sales price. The department also invites the local assessors to accompany them in the fielding of these sales, to the mutual benefit of both. Only the department of taxation should be permitted to use these sales letters, as it has been proven, that where both the department and the assessor duplicate this work, neither has a complete record, as the taxpayer generally replies only to the first letter received.

6. *The department of taxation to furnish commodity and equipment prices.* These items of information could be furnished in supplemental form to an assessors' manual, for the reason that the department could more easily and less costly do this through a research department than could the individual assessors, handicapped by lack of time and funds. Such information, if it was available, would not only prove a help to the local assessors, but would be a complementary aid to the supervisors in insuring uniformity as between the supervisor and the assessor for equalization purposes.

7. *The department of taxation to furnish inventory information to the local assessors.* Inventories are of vital importance in the making of personal property assessments, and should be available prior to the assessment season, for study, before actual work is commenced. This information was furnished by the old tax commis-

sion and is now furnished only in part. Corporation returns are now furnished because of their being filed at Madison, whereas individual inventories are not available because of the segregation of districts and the size of these districts. The income tax division does not have sufficient help to provide the district offices with this information, and the district offices are likewise handicapped. Corporation returns are now dexigraphed and loaned to the assessors.

A simplified procedure for both corporation and individual returns could be instituted at less than the cost of the present dexigraphing method. This could be done by simply providing a duplicate sheet in the income tax return, which sheet could be revised to give the assessor the vital information he needs, such as inventories, gross sales and purchases, rentals paid or received, and furniture, fixture and equipment costs and depreciation.

It is strange that while income taxes represent only 8% of the total taxes raised in Wisconsin, they have become such a political pet that they have been provided with the greatest amount of secrecy, to probably cover up an arbitrary, uncertain and haphazard tax. It is a costly form of taxes, requiring vastly greater personnel to administer than does real estate in which the taxpayer is not allowed to make a self-assessment as they do in this perplexing tax. Therefore, I see no good reason why a duplicate form could not be provided for, in which the definite information required by the local assessor, and which cannot be easily juggled, could be furnished. Immediately upon the filing of the income tax return with the income assessor, this duplicate sheet could be detached and turned over to the supervisor, who in turn would transmit this information to the local assessor. It would also provide the supervisor with the needed information for equalization work.

While it is true that the local assessor has access to the taxpayers' books and records, he is handicapped by the lack of time to do this. In many instances the books are not always available because some public accountant has them in his office or home. Then, again, it has been my experience to encounter more than one set of bookkeeping, as well as a more cooperative attitude on the part of the taxpayer, when he knows that this same information desired has been previously obtained.

8. *Prescription of standardized forms and practices.* The statutes provide that the department of taxation shall prescribe all forms necessary in the assessment and collection of taxes, and could very easily provide for the duplicate income tax return previously mentioned herein. The department does stress the desirability of uniformity in our personal property blotters, real estate field blotters, assessment and tax rolls. This type of work should be carried on, as it helps to provide better assessments and more legible work, and if some forms or types of reports were made more complicated, it

would tend to get better qualified assessors. It is one thing to make poor assessments which might be acceptable to the local governing body, but another thing to make out a complicated report of the assessment roll to the state department.

9. *Corporation auditors and legal help.* The state department should have available the use of a corporation auditor who would be able to aid local assessors in determining accounting practices in disputed assessments. Occasions have arisen where accounting records have become evidence in a disputed assessment, but because of the lack of information or ability to decipher these records, local assessors have lost important points in review. Such was the case of the International Business Machines where, through able counsel, the company was able to submit certain records which, I believe, if they had been expertly analyzed, would have provided more taxable property.

The same argument can be advanced for legal counsel well versed in taxation to aid local communities in the more severe problems. It is rarely, if ever, that city attorneys are able to do expert work before boards of review or the courts in important cases. The assessor who tries to do good work often loses out because he does not have available good legal help and advice.

10. *County addressograph systems.* Manitowoc County was the first county in the state to provide a central listing office, which office provides the following services:

a. Keeps a complete record of every taxable parcel by taxation districts on metal plates.
b. Keeps this record up to date with all transfers of property.
c. Writes all assessment and tax rolls and tax bills on standardized forms, at the required time.
d. Keeps complete plat books to scale of all taxable properties.

These are the important duties, but many other additional duties are performed in connection therewith. This system provides a legible up-to-the-minute record, and saves each taxation district additional expense which would be required to do this work, and gives the assessor more time to actually make assessments because he does not have to write the rolls. Probably one of its most important features is the fact that once the property description has been prepared and checked on this metal plate, it becomes a permanent record. Some 40-odd counties in the state now use this system, and while it is not actually a state department function to either advocate or encourage this system, it should not be divorced from the state department duties because the statutes provide that the department shall systematize assessment procedure, and shall prescribe standardized forms. To my mind, this is one of the important functions of assessment procedure because, through its setup, the possibility of incorrect legal descriptions is almost eliminated.

11. *State tax department field supervisor.* Previously, under the old tax commission, there existed a traveling supervisor whose duty was to coordinate the several district offices and to aid local assessors on particular problems. This was discontinued by the old commission and has not as yet been revived by the new department of taxation. Such a supervisor or traveling agent is, in my mind, a step forward, inasmuch as such an individual would, in a sense, provide the expert advice on individual problems now needed in assessment procedure. In other words, he would be the expert so often needed on individual problems.

In conclusion, I can only say that these are but a few of the many arguments which can be advanced to show the importance of the general property tax, and the necessity for improvement in its administration, and that through it all, I believe that the burden for this improvement lies in the lap of state departments of taxation. It can only be through their efforts that immediate results for the betterment of the profession can be obtained. All other sources of effort are too slow-moving. County and state boards of equalization or review, usually unacquainted with the location of property, and working with limited time and information, probably create as many inequalities about as often as they remedy them. The only solution to the problem of equalization is the source, which is the original assessment made by the assessor. Unless the original assessment is properly made, all subsequent steps will prove insufficient in obtaining equalization. Therefore, too much stress cannot be laid upon proper supervision, to the end that the profession shall attain its proper recognition.

CHAIRMAN SCOTT: It has been my privilege to have had the acquaintance of the next speaker, Mr. J. L. Jacobs, and am familiar with the splendid character of the work accomplished by him. Mr. Jacobs was the first county assessor in Cook County, Illinois. He was appointed to that post in 1931 after the former board of assessors had been abolished. Under his supervision, a scientific assessment system was installed in Cook County, which was in itself a tremendous undertaking. Since leaving this office in 1935, he has been continuously engaged as consultant on administrative procedure in local and state government. He has been particularly interested in revaluation programs. Some of the largest revaluations in the country were made under his supervision. These are the revaluation of Lucas County (Ohio), in which Toledo is located, and the recently completed job in Jackson County (Missouri), in which Kansas City is located.

Mr. Jacobs will discuss the "Equalization of Assessments."

STATE TAX DEPARTMENT RESPONSIBILITY FOR LOCAL ASSESSMENTS: EQUALIZATION OF ASSESSMENTS

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THE EQUALIZATION FUNCTION

This part of the discussion on state tax department responsibility for local assessments deals primarily with the assessment equalization function by county and state equalization agencies as distinguished from assessment review powers which are exercised most frequently by agencies having jurisdiction over one assessment district.

The equalization function includes the readjustment by a uniform percentage increase or decrease of the assessed valuation of all properties of a particular class or classes of property within an assessment district. Such equalization is directed primarily to bring the level of all property assessments in line with two or more assessment districts to a substantially uniform average level of valuation in order to assure more equitable distribution of taxes on all or specific classes of properties in the respective assessment districts.

Reports on property assessment ratios from an increasing number of states indicate a definite trend for improvement in procedure and records for assembling, sampling and determining average assessment ratios in urban and rural areas. Most of these reports are from studies by state tax agencies, by agricultural departments of state universities and by private agencies.

This summary presentation does not go into bases of assessment or tax rate limits nor the merits of full or percentage property valuation. It is directed primarily to point out the extent and nature of property assessment and tax inequalities and the definite trend for use of uniform systems in original assessment and in assessment equalization. These also indicate increasing opportunities for county and state-wide collaboration for technical and nonpartisan administration of original assessments and of equalization of assessments between assessment districts within each state.

CONDITIONS AFFECTING ASSESSMENT EQUALIZATION

Increasing attention is being given to equalization of assessments to the prevailing level on which all property and specific classes of property is assessed in individual jurisdictions, in counties and for the state as a whole.

Many assessing and tax officials are giving recognition to the conclusion stated by the Supreme Court of the United States that

"where it is impossible to secure both the standard of the true value, and the uniformity and equality required by law, the latter requirement is to be preferred as the just and ultimate purpose of the law." With changing assessment levels and higher tax rates, substantial uniformity of property assessments and taxes must be obtained through technical, impartial analysis and reporting on assessment levels and through application of county and state-wide equalization factors. Official action is induced where carefully prepared data on assessment ratios are developed and presented as a basis for assessment equalization.

In carrying through real equalization of property assessments, most county and state equalization agencies are confronted with varying types and standards of assessment administration.

The principal cause of inequalities in assessments and in tax equalization is the absence of uniform system for determining the valuation of different classes of property in original assessments. An outstanding factor in true equalization of assessments and taxes is therefore the quality and character of original assessments.

Marked improvement in original assessment has been accomplished by some assessing offices through application of accepted procedures in appraising different classes of property for tax purposes. In such cases, the problems which equalization agencies have in determining the average level of assessment for different properties in different jurisdictions are greatly simplified.

On the other hand, there are numerous jurisdictions where the original assessment is largely a conglomeration of inequalities with many varying peaks and valleys in individual assessments. In such cases, assessment inequalities are found between individual properties of the same type, between classes of property and between different areas in the same jurisdiction. Such an original assessment naturally makes for wide variations in assessment levels for all classes of property in a district and between assessment districts and counties.

The gravest inequalities in initial assessments are found where assessing and reviewing offices are required to operate with utterly inadequate personnel and equipment and without uniform system and standards now generally recognized as essential in making sound property appraisals.

In the case of real property assessments, most of these offices operate without such elemental information as land and tax maps, inventories of lands, buildings and improvements or of records of property appraisals, sales, prices and other economic trends. Without these appraisal tools and procedures, it is only natural that inequalities in the original assessment and in property tax distribution are the rule.

The usual conditions under which most assessing offices operate and the procedures and records used in the assessment of various classes of personal property are also inadequate to assure substantial uniformity in assessments and tax equalization.

In those cases where original assessments are made and extended as above outlined, assessing officials have the primary duty in establishing a uniform system and in providing adequate records and standards for appraising different classes of property. With the widening understanding and support of property owners and taxpayers for improved tax administration, many of the larger and some smaller assessment offices are adopting and applying such uniform systems. In many instances this is being done with the collaboration and assistance of the state tax agency.

Where assessments are made on the basis of sound appraisal practice, they give assurance that taxes levied by governmental agencies in any one assessment district will be distributed in the same proportion that the value of property of a given class bears to the value of all property in such class. Furthermore, such original assessments and system of records tend toward equalization of levels and furnish a factual basis for just equalization of valuations between districts.

PROCEDURE FOR IMPROVED ORIGINAL ASSESSMENT

The state tax agency has a definite responsibility and opportunity in providing uniform procedures and in assisting local officials in the application of such procedures in order to assure uniform original assessments and equalization. The overall approach which a state tax agency can use with relatively small technical supervision, places the state tax agency in an excellent position to influence better initial assessments and truer assessment equalization by county and state equalization agencies.

An effective method used by some state agencies in establishing and maintaining systematic methods in different jurisdictions is the development of a manual of procedures and standards as guides to local officials in the valuation of various classes of property.

The primary purpose of such a state manual is to make available to the local assessing and reviewing officials a uniform system to aid them in establishing equitable property assessments. Such simplified procedures and unit value standards should be so organized that they may be readily adapted and used by regular assessors in the assessment of individual properties.

The distribution by the state tax agency of such manual information is an outstanding step toward county and state-wide application of uniform system of assessment for tax purposes. Periodic conferences and review of such procedures with local assessors and provision of technical assistance by the state tax agency to the local

assessors, and particularly to assessors in the smaller assessment districts, tend toward greater uniformity in original assessments and in more equitable tax distribution within and between the respective jurisdictions.

ALTERNATIVE METHODS OF EQUALIZATION

With the variations in the character and quality of assessment administration, the process of equalization between jurisdictions must be adjusted to the varying conditions. Alternative methods or combination of such methods must be used by county and state equalization agencies to obtain a true basis for the ratio of assessment applicable to all or specified classes of property by districts and for the state as a whole.

The sales ratio method gives reasonably accurate results where adequate samples of bona fide sales of different property classifications are regularly assembled, analyzed and summarized.

In areas where samples of bona fide sales are inadequate both as to number and classification, the appraisal method has been used to supplement the sales ratio method. Under this procedure, definite classifications and specifications are set up for typical properties and uniform procedure applied in appraising an adequate sample of typical properties in the given jurisdictions. Determination of the ratio of the total assessments to total appraised values of the typical properties, weighted according to distribution of properties, furnishes a good basis for equalization between jurisdictions.

In jurisdictions where either the sales ratio or appraisal ratio methods reflect wide variations in original assessments, the wholesale appraisal method is essential. This procedure requires the application of a uniform system for determining the valuation of all property classifications in the jurisdiction. Where this procedure is used, an equalization factor representing the general custom and use level in the valuation of property under existing tax bases is applied to all original assessments. The application of similar equalization factors in different assessment jurisdictions assures truer tax equalization both for properties within and outside of the respective jurisdictions.

MANUAL OF EQUALIZATION PROCEDURE

The state tax agency can and should lead in furnishing definite, simple procedures and in assisting in the assembly and distribution of information to local and county officials on original assessments and on the equalization of assessments between jurisdictions. This is particularly necessary in the smaller assessment districts. Also in the larger jurisdictions where insufficient personnel and equipment is available for such work.

Development by the state tax agency of basic equalization procedures and periodic determination and reporting on average assessment ratios based upon such data, will not only strongly influence and make for better initial assessments but will also aid the county and state equalization agencies in accomplishing equalization in different assessment districts.

A manual of assessment equalization procedure should include the following major divisions:

(1) Classification of classes and types of properties, with definitions of sub-classifications for urban and rural lands and for residential, apartment, commercial, industrial and farm properties.

(2) Schedule of operations with forms and records for use in recording, summarizing and reporting property sales and appraisals.

(3) Procedure for assembling, investigating and reporting on sales and appraisals of properties under major property subclassifications and for assessment districts.

(4) Procedure for classifying, interpreting, weighting and summarizing assessments, sales and appraisals and of assessment ratios for specified property classes and for all properties within a given jurisdiction and in different jurisdictions.

(5) Rules of practice in connection with the investigation and action on equalization findings ordered by the county and state equalization agencies.

In order to assure continuing administration of the assessment equalization system after initial application, the adopted procedures and standards should be jointly subscribed to and used by the county and state equalization agencies. Joint action of this character is imperative to assure uniform and continuing application to subsequent assessments and for proper adjustment of equalization factors as additional information becomes available on property conditions and on the custom and usage in different jurisdictions in the state.

Such systematic procedure for uniform assessment and equalization can best be developed by the state tax department in close collaboration with local assessing officials and with civic, educational and technical committees having source information in regard to property conditions, costs, sales, and other elements affecting property values and tax equalization. Developed along these lines, they can be directly adopted and applied by those offices which are in position to employ the necessary technical staff or can be applied for the smaller and sparsely settled areas by the county and state equalization agencies in the equalization process.

ORGANIZATION OF EQUALIZATION AGENCIES

With regard to problems of organization and personnel of assessment and equalization agencies, an excellent report has been made by the National Association of Assessing Officers as the result of the work of the Committee on Assessment Organization and Personnel under the chairmanship of James W. Martin. I desire to commend the committee on the thorough treatment of this subject and its findings and recommendations as included in the volume on "Assessment Organization and Personnel" recently issued by the National Association.

The committee makes the following sound and practical recommendations in its summary on the organization and personnel of equalization agencies:

> "(1) The need for local equalization agencies should be removed by the enlargement of local assessment districts, by functionalization and close coordination of the work of deputy assessors, and by an expansion in the activities of state equalization agencies.
>
> (2) A state equalization agency should be maintained in at least those states which impose taxes, share taxes, or make grants-in-aid on the basis of local assessed valuations, or in which some property is state-assessed but is taxed at local rates or at an average of local rates.
>
> (3) Members of an equalization agency should be chosen at large by a person or persons representing the whole equalization district and not by representatives of portions of the district.
>
> (4) Equalization agencies should be given powers of assessment review unless independent agencies for assessment review and for assessment supervision exist on the same level, in which case the equalization function should be assigned to the supervisory agency.
>
> (5) State equalization agencies should be permitted to equalize by minor tax districts and by classes of property as well as by counties.
>
> (6) Equalization agencies should be given the option of ordering changes in individual assessed valuations or in tax rates and distribution ratios."

Real equalization of property assessments and taxes will become the general rule as uniformly sound original assessments are provided by assessing officials and as accepted methods of equalization are used and equalization factors determined on the basis of factual data by technical, impartial and non-political equalization agencies.

State tax departments have a great responsibility and opportunity in developing and supplying definite system of procedures and assist-

ing local and county offices in the application of uniform system of assessment and equalization.

As such systematic procedures are provided and technical, impartial assistance assigned on these activities, definite improvement in original assessments and in tax equalization will be accomplished in an increasing number of assessment jurisdictions in each state.

CHAIRMAN SCOTT: For nearly four years, Dr. Welch has devoted his time and efforts in bringing the work of the committee to a successful completion. He is research director of the National Association of Assessing Officers, and will treat the subject under the head of "Administrative Review of Local Assessments."

STATE TAX DEPARTMENT RESPONSIBILITY FOR LOCAL ASSESSMENTS: ADMINISTRATIVE REVIEW

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There is an old and familiar tale of a committee of blind men who set forth to examine an elephant and returned to describe it variously, each according to the limited portion of the elephant's anatomy which he had touched. Similarly diverse opinions might conceivably be expressed by persons who set out to examine the process of administrative review of local assesments by state agencies. To some it appears to be part of the equalization function, a viewpoint which finds expression in laws directing or empowering the state board of equalization "to equalize the assessments of all property in this state between persons, firms or corporations of the same district, between townships and cities of the same county, and between the different counties of the state."[1] To others it appears to be part of the supervisory process. The laws providing for extensive central supervision of local assessors usually contain a variety of clauses which, literally interpreted, would give the supervisor review powers, most obviously the clause empowering the supervisor to reassess "any or all" property in an assessment district.[2]

[1] *Kansas General Statutes, 1935*, sec. 79-1409. See also *Arizona Code, 1939*, sec. 73-106; *Carroll's Kentucky Statutes*, sec. 4114i-16; *Montana Political Code, 1935*, sec. 2122.8(5); *South Carolina Code, 1932*, sec. 2431; *South Dakota Code, 1939*, sec. 57.0419; *Remington's Revised Statutes of Washington*, sec. 11091(3).

[2] See *Public Acts of Alabama, 1935*, H. B. 324, sec. 93; *Pope's 1937 Digest of the Statutes of Arkansas*, sec. 2055; *Idaho Code, 1932*, sec. 61-506; *Kansas General Statutes, 1935*, sec. 79-1413; *Maine Revised Statutes, 1930*, ch. 12, sec. 10; *Michigan Compiled Laws. 1929*, sec. 3547; *Mason's Minne-*

And to still others administrative review on the state level appears to be a judicial process by which disputes between taxpayers (or taxing districts) and the lower administrative review boards are settled more informally, and perhaps more expertly, than they could be in the heavy atmosphere of the court room. This third viewpoint finds expression in laws granting to aggrieved parties the right of appeal to the appropriate state agency.[3]

Because of the different terms employed in the conveyance of review powers, as well as the absence of generally accepted definitions of "assessment review" and "administrative agencies", it is impossible for me to say exactly how many state administrative review agencies are in existence. However, they can safely be said to number between twenty and thirty-five; and, if pressed for a more precise statement, I would say that there are 29 such agencies, representing 26 different states.[4] Certain it is that the number is

sota Statutes, sec. 2365(2); *Nebraska Compiled Statutes, 1929*, sec. 77-304; *New Hampshire Public Laws, 1926*, ch. 68, sec. 12; *North Dakota Compiled Laws, 1913*, sec. 2092a5(1); *Oregon Compiled Laws Annotated*, sec. 110-602; *Utah Revised Statutes, 1933*, sec. 80-5-47; *West Virginia Code, 1931*, ch. 11, art. 3, sec. 1. Although all of the states listed in this footnote have laws of the type referred to in the text, seven of them (Arkansas, Idaho, Maine, Nebraska, New Hampshire, North Dakota, and West Virginia) are not generally considered to have state administrative review agencies. With the possible exception of New Hampshire, the supervisory agencies of these states apparently do not engage in anything which could be classified as review work, and it is quite probable that their courts would prohibit such activities if they were undertaken under conditions inviting litigation. In the latter connection, see *Bank of Jonesboro* v. *Tax Commission*, (1909) 92 Ark. 492, 123 S. W. 753, in which it was held that power to change individual assessments will not be assumed unless explicitly conferred upon a state agency, the presumption being that this power lies in the local review boards.

[3] See *Burns' Indiana Statutes Annotated, 1933*, sec. 64-1321; *Kansas General Statutes, 1935*, sec. 79-1409; *Annotated Code of Maryland*, art. 81, sec. 183; *Massachusetts Acts and Resolves, 1930*, ch. 416; *Montana Political Code, 1935*, sec. 2122.9; *Statutes of Nevada, 1939*, ch. 180; *New Jersey Revised Statutes, 1937*, sec. 54:2-35; *New Mexico Supplement, 1938*, sec. 141-230, 141-508; *North Carolina Public Laws, 1939*, H. B. 45, sec. 202(3), 1107; *Ohio Laws, 1939*, S. B. 159, sec. 15 (amending *General Code*, sec. 5610); *Oregon Compiled Laws Annotated*, sec. 110-609; *South Carolina Code, 1932*, sec. 2747, 2779-A; *South Dakota Code, 1939*, sec. 57.0417; *Michie's Tennessee Code, 1398*, sec. 1450; *Utah Revised Statutes, 1933*, sec. 80-7-10; *Remington's Revised Statutes of Washington*, sec. 11087-6; *Wisconsin Statutes*, sec. 70.85.

[4] The states which I include in this total are: Alabama, Arizona, Colorado, Indiana, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota (2 agencies), Missouri, Montana, Nevada, New Jersey, New Mexico, North Carolina, Ohio, Oregon, South Carolina (3 agencies), South Dakota, Tennessee, Utah, Washington, Wisconsin, and Wyoming. State boards of tax appeals are considered administrative review agencies in this enumeration although several of them would be classified as judicial review agencies by some commentators.

increasing. There was apparently only one state which had a state review agency in 1880, two in 1890, five in 1900, nine in 1910, eighteen in 1920, twenty-five in 1930, and twenty-six in 1940.[5] This increase has occurred in spite of the abandonment of state review after a trial period in at least one state.[6]

There is a deplorable lack of published information on the activities of state administrative review agencies, and this is especially true of activities which are *initiated* by review agencies. State tax officials with supervisory as well as review duties are understandably reluctant to publicize cases in which they have overridden local assessors on their own motion. However, all of the evidence is to the effect that review powers are seldom invoked except upon appeal, although there may very well be instances in which the state tax department encourages interested parties to file appeals when the alternative is to proceed on its own initiative to correct a situation which it finds intolerable. There are, of course, some state review agencies which can act only on appeal.[7] But data on the receipt and disposition of appeals are only slightly less adequate than those on initiated actions of state review boards. In fact, a search of tax reports of recent years discloses that such data are published for less than half the states. Few of these reports contain anything more than the number of appeals filed.

[5] The earliest provisions for administrative review which I have found in the 26 states listed in the preceding footnote are as follows: Minnesota, 1878 (ch. 1, sec. 119); South Carolina, 1882 (Act 17, sec. 242); Indiana, 1891 (ch. 99, sec. 125); New Jersey, 1891 (ch. 114, sec. 1); Michigan, 1899 (Act 154, sec. 152); North Carolina, 1901 (ch. 7, sec. 8); Alabama, 1907 (p. 372); Kansas, 1907 (ch. 408, sec. 12, 17); Ohio, 1910 (p. 421); Colorado, 1911 (ch. 216, sec. 13); Arizona, 1913 (ch. 71, sec. 4, 22); South Dakota, 1913 (ch. 352, sec. 10); Maryland, 1914 (ch. 841); Louisiana, 1916 (Act 140, sec. 13); Missouri, 1917 (p. 549); Tennessee, 1919 (ch. 1, sec. 7); Wisconsin, 1919 (ch. 384); Wyoming, 1919 (ch. 135, sec. 11-1); Kentucky, 1922 (ch. 114, sec. 6); Montana, 1923 (ch. 3, sec. 9); Washington, 1925 (ch. 18, sec. 5-6); Nevada, 1929 (ch. 177); Oregon, 1929 (ch. 465, sec. 6; Massachusetts, 1930 (ch. 416); Utah, 1931 (ch. 53); New Mexico, 1933 (ch. 104, sec. 1).

[6] The Iowa State Board of Assessment and Review was invested with review functions upon its creation in 1929, but this law was repealed in 1937. California voters apparently tried to grant review powers to their state board of equalization in adopting their constitution in 1879 (see Art. XIII, sec. 9), but the supreme court of the state refused to take their words at face value (see *Wells Fargo and Co.* v. *State Board of Equalization*, (1880) 56 Cal. 194, 198).

[7] Appeals are believed to be prerequisite to state review in Maryland, Massachusetts, Nevada, New Jersey, North Carolina, Ohio, Washington (see *State ex rel. Tax Commission* v. *Redd*, (1932) 166 Wash. 132, 6 Pac. (2d) 619, and *State ex rel. King County* v. *Tax Commission*, (1933) 174 Wash. 668, 26 Pac. (2d) 80), and Wisconsin. The Kentucky Tax Commission, and possibly the Alabama Commissioner of Revenue and the Louisiana Tax Commission, can act on its own motion but not on appeal (see *Perry County* v. *Kentucky River Coal Corporation*, (1938) 274 Ky. 275, 118 S. W. (2d) 550).

The number of appeals filed in 11 states for which data have been found varies tremendously.[8] In Wisconsin, the number has averaged 29 per year over the past decade, while New Jersey appeals have averaged over 23,000 a year for the past five years. Even when reduced to a per capita basis for comparative purposes, the variations are nearly as great (see Table I). Average annual appeals in Wisconsin number 9 per million inhabitants as compared with 5,574 per million in New Jersey. Massachusetts appeals number over 1,000 per million inhabitants, Maryland's number over 700, Ohio's over 200, and Montana's over 150. Michigan, Missouri, Oregon, Utah, and Washington have between 10 and 100 appeals per million inhabitants.

TABLE I

NUMBER OF APPEALS FILED WITH SELECTED STATE ADMINISTRATIVE REVIEW AGENCIES IN RECENT YEARS [a]

State	Period Covered	Total No. of Appeals	Ave. No. per Year	Ave. Annual Appeals per 1,000,000 Population
Maryland	1935-1938	5,308	1,327	729
Massachusetts	1932-1940	39,635	4,404	1,020
Michigan	1933-1934, 1937-1938	457	114	22
Missouri	1937-1938	89	44	12
Montana	1939-1940	178	89	159
New Jersey	1936-1940	115,947	23,189	5,574
Ohio	6/5/39-7/1/41	3956	1,913	277
Oregon	1935-1940	342	57	52
Utah	1938-1940	123	41	75
Washington	1931-1934, 1937-1940	461	58	23
Wisconsin	1930-1939	293	29	9

Sources: Official state reports; correspondence; *Papers Presented at the Northeastern Regional Conference on Assessment Administration* (National Association of Assessing Officers, 1941).

[a] The periods covered by this table vary considerably from state to state, and this naturally somewhat impairs the comparability of the data. As a rule these differences are attributable to (1) failure of the review agency to report the data comparably from year to year or (2) the absence of certain reports from the libraries to which the writer had access during the preparation of this paper.

It is difficult to explain these wide variations, although several partial explanations spring readily to mind. For example, there are

[8] Although it reports complete information, Minnesota is not included among these 11 because it is difficult to distinguish review activities from equalization and reassessment activities in this state.

seven states[9] in which the line of appeal is bifurcated, with one branch running to the state review agency and the other to the courts, while Massachusetts taxpayers may appeal either to the appellate tax board or their county commissioners. In several instances, the right of appeal to the state review agency is not clearly established in these states, with the result that the courts are resorted to by most aggrieved taxpayers.

There is also a difference in the number of local review agencies injected between the local assessors and the state administrative review agencies, each of which sifts out some grievances. There are no such agencies in Massachusetts and Maryland (except in the city of Baltimore), two in Minnesota and South Dakota (and in Charlestown County, South Carolina), and one in the other 22 states with central administrative review agencies.

Another rather obvious factor influencing the number of appeals reaching the state review agency is the severity of this agency. The Oregon Tax Commission reduced assessments in only 22 per cent of the appeals which it received in the years 1937 through 1939; and the comparable percentages for the other state tax commissions which have reported this information are 35, 38, and 65.[10] Contrast these figures with the 95 per cent recently estimated for New Jersey[11] and you see one reason why the New Jersey Board of Tax Appeals hears such a relatively large number of appeals.

A fourth reason for variations in the number of assessment appeals is that the quality of original assessments varies somewhat from one state to another. However, this is probably a less important reason than it would seem to be at first glance, both because the quality of assessments tends to vary much more within states than among states and because there is at best a poor correlation between the quality of assessing and the number of assessment appeals. A much stronger correlation will be found between the number of appeals and the percentage of true value at which the assessor seeks to list property. A high assessment level is likely to produce a large number of appeals, yet it is fairly well established that a high assessment level also tends to be associated with a high degree of equality in the original assessment.

These are only a few of the reasons why some state review agencies handle a much larger number of cases than others. There is apparently a tendency for state boards of tax appeals to hear more

[9] Alabama, Arizona, Colorado, Louisiana, Minnesota, Ohio, and South Dakota.

[10] These percentages apply, respectively, to the following states: Wisconsin (1930-1939); Utah (1938-1940); and Michigan (1933-1934, 1937-1938).

[11] Albert H. Kraemer, "Assessment Review in New Jersey", *Papers Presented at the Northeastern Regional Conference on Assessment Administration.* The estimate is based on a rather small sample of the appeals decided in 1940.

appeals than state tax departments.[12] But this does not necessarily mean that the review activities of state boards of tax appeals are more influential than the review activities of state tax departments. Even the most active state agencies review only about one out of every hundred local assessments, and the percentage so reviewed in most states is infinitesimal. Since it is principally the large assessed valuations that are appealed to the state agencies, the ratio of appealed assessments to total assessments is larger when stated in dollars; but it is probably still less than one per cent in all states except Massachusetts and New Jersey. Consequently, a state review agency which has a slightly beneficial effect upon unappealed assessments is of greater value than one which handles appeals perfectly but does nothing to improve unappealed assessments. It would be unfair to state boards of tax appeals to say that they do nothing to improve original assessments which are never appealed to them, but it is obvious that their opportunities in this field are limited compared to those of most state tax departments.

Most states which have transferred review powers from state tax departments to state boards of tax appeals have left extensive supervisory powers with the state tax departments. In a sense, the board of tax appeals has been given the responsibility of correcting unequal original assessments while the tax department has been expected to see that future original assessments contain fewer inequalities. It is my opinion, however, that a tax department which has no review powers is likely to supervise assessors less effectively than one which has the same supervisory powers plus review powers. There are several reasons why this might well be true. For one thing, legislatures are probably more liberal with their appropriations to review agencies than to supervisory agencies, as such.[13] Furthermore, a review agency is constantly confronted with evidence of the need for supervision of original assessments, and is at the same time possessed of a convenient means of implementing its decisions relative to such assessments. Finally, an agency which must hear assessment appeals is likely to feel a real sense of responsibility toward local assessors and property taxpayers, whereas it is a well-known fact that powers of general supervision have called forth little response from a great many state tax departments.

The weight of authority definitely favors some sort of administrative review agency on the state level. The National Tax Association's Committee on Administration of Laws for the Taxation of

[12] Several states have nominally included their state boards of tax appeals within their state tax departments. However, these state tax departments contain two substantially independent agencies—the board of tax appeals and the office of the tax commissioner—and only the latter is referred to as a tax department in this paper.

[13] The fact that the New Jersey Tax Department has had no appropriation for assessment supervision for years is illustrative of this point.

Property recommended without too much enthusiasm that the state tax department have review powers,[14] and the Committee on a Model System of State and Local Taxation recommended it without qualification.[15] The National Association of Assessing Officers has made a somewhat similar recommendation at the instigation of its Committee on Assessment Organization and Personnel.[16]

The first two of these committees reported before the state board of tax appeals had become institutionalized, and the third did not feel obliged to choose between review by state boards of tax appeals and review by state tax departments. However, one senses a preference on the part of students of public administration and public finance for review by the state tax department, while the legal profession is probably partial to the state board of tax appeals. It is easy to see why lawyers favor boards of tax appeals. The procedures of such boards are more similar to those of a court, and taxpayers are more likely to be represented before them by legal counsel. Furthermore, taxpayers who appeal their assessments are apparently more likely to receive favorable judgments from a board of tax appeals than from a state tax department. Those whose interests lie primarily in the field of public administration, on the other hand, are less interested in protecting the rights of the small minority of taxpayers who appeal from decisions of local boards of review than in strengthening the original assessment process; and this, it seems, is fostered by lodging powers of review in the state tax department. On one point, most authorities on taxation, whether lawyers, administrators, economists, or political scientists, are agreed: review of local assessments by a state tax department or a state board of tax appeals is preferable to the court review which is still permitted in approximately half of the 48 states of the union and in two-thirds of the 22 states which have provided for no administrative review on the state level.

CHAIRMAN SCOTT: Mr. Joel Hunter was a one-time student of Dr. Martin, and assisted in the Kentucky Department of Revenue. He has recently written for the *Journal of Accounting*, in which he deals with one phase of his work in Kentucky. He has had a good deal of accounting experience, as well as taxation work, incident to state and local progress in Georgia. Mr. Hunter has prepared a most exhaustive and complete paper on "Multiple Member Board of Review."

[14] *Proceedings of the National Tax Conference* (1911), v. 5, p. 373.

[15] *Proceedings of the National Tax Conference* (1919), v. 12, p. 465; (1933), v. 26, p. 409.

[16] *Assessment Organization and Personnel*, 1941, pp. 21, 258.

THE STATE BOARD OF REVIEW IN LOCAL PROPERTY TAXATION

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1. INTRODUCTORY

The board of review functions as a state instrumentality, independent of the revenue administering authority, for settlement of disputes between local assessors and taxpayers. This function is distinct from equalization, or review of assessments in the mass. It is also separate, for purposes of this discussion, from determination of disagreements in respect of central assessments, or assessments made by state tax administrators, although the same board may be authorized to review assessments both of local and central tax administrative agencies. The jurisdictions of the independent boards of review of all kinds which now exist in ten states vary considerably, but in no case is there a board organized and operating in the review of local assessments only. Notwithstanding this extended jurisdiction, it appears that the number of appeals based upon local assessments tends greatly to exceed the number of appeals from central assessments. This follows logically, perhaps, from the larger number of local assessments and assessing officers as well as the greater element of discretion which is generally involved in the typical locally administered property tax.

The board of review stands in the settlement of contested local assessments as an agency intermediate between the tax administrators and the courts. It partakes of the nature of both. Its proceedings may be informal, representation by an attorney-in-law may not be necessary, and a stenographic report may not be made nor a written decision filed. Yet there is almost invariably one or more attorney members and, though not always invoked, provision for formal procedure, transcripts of proceedings, and the application of the rules of evidence as obtaining in the state courts. Procedure is thus more flexible than before the courts and small causes may be determined with less emphasis upon procedure, while at the same time those cases which involve important precedents or are for other reasons distinguished, may be so tried as to make the full decision of the board available for the guidance of taxpayers and the record adequate to support an appeal to a higher tribunal.

Three of the ten boards are concerned with local assessments. In Massachusetts and New Jersey boards have existed for about ten years, through successive changes in administration. The Ohio board is somewhat younger and has not had as large a volume of local assessment cases with which to deal.

2. MASSACHUSETTS

Massachusetts local property tax is imposed on real estate and tangible personalty only. Taxpayers dissatisfied with assessments may request local boards of assessors for abatement of tax and, upon failure to secure relief, may follow either of two courses. A petition may be filed with the appellate tax board [1] or with the local board of county commissioners,[2] the latter being the remedy coexisting with appeals to the courts prior to the creation of the appellate tax board in 1930. The local board of assessors are privileged to remove appeals originally brought by the taxpayer before the board of county commissioners, and to have such cases determined by the appellate tax board.[3]

Two classes of procedure before the appellate tax board are authorized by Massachusetts law and the rules of the board. The older formal procedure follows closely the procedure in the state courts.[4] The action is initiated by the filing of a petition setting out facts upon which the taxpayer relies and his contentions of law. The taxpayer must serve a copy of the petition upon the board of assessors. Within thirty days the assessors may either reverse themselves and grant an abatement to the taxpayer or must file an answer with the appellate tax board. The answer must admit or deny each allegation of fact in the petition, and set out all findings of fact or conclusions of law which the assessors have made in the case.

The informal method of procedure was first instituted in 1933.[5] This development is of interest as providing an inexpensive and conclusive method of settlement of local tax disputes. Under informal procedure the applicant is required to file a waiver of the right of appeal to the Supreme Judicial Court from the appellate tax board findings except upon questions of law. A written election of the informal procedure must be filed by the appellant. A written statement of facts and the amount claimed in abatement, also required, may be prepared for the taxpayer by the clerk of the board upon forms which the board supplies provided the assessed value of the property does not exceed $20,000.[6] The clerk serves a copy of the informal petition upon the assessors, including copies of the waiver of appeal and election. The assessors may then elect to have the procedure follow the formal method, if the assessed value of the

[1] *Mass. G. L.*, c. 58A; *St.* 1933, c. 321, sec. 1, 8, 9; *St.* 1937, c. 400.

[2] *Mass. G. L.*, c. 59, sec. 64.

[3] *Ibid.*

[4] *Mass. G. L.*, c. 58A, sec. 7; Rules 3, 4 and 37.

[5] *Mass. G. L.*, c. 58A, sec. 7-A; Rule 6.

[6] Rule 7, Mass. Appellate Tax Board.

property is over $20,000, by notifying the clerk to this effect within ten days.[7]

Hearings upon appeals from a decision of a board of assessors may be by a single board member who may, in addition, decide the issue if it is purely a question of over-valuation, and if the assessed value of the property involved is less than $25,000. A single member may also decide the case if written consent is filed by the taxpayer prior to submission of evidence, where the assessed valuation is between $25,000 and $50,000.[8]

Filing an appeal with the board does not stay collection of the tax. With certain exceptions designed to relieve taxpayers from the hardship of excessive levies, the tax is required to be paid before entry of the appeal.[9]

Witnesses may be summoned and the production of books and records required in the same manner as before the courts.[10] The board causes stenographic notes to be taken of its proceedings, but transcripts based thereon are not available to litigants unless request is made and cost paid one day or more before hearing.[11]

The board may make findings of fact and written reports in any case except informal procedure cases. Its decisions are final as to matters of fact, with appeals to the Supreme Judicial Court upon matters of law.[12] Forms for formal and informal procedure petitions, waivers of appeal and election of informal procedure, subpoena, application to take depositions, order, and return, as well as other forms are prescribed by the board.[13] Upon entry of the board decision an order issues to the clerk of the local board of assessors and the taxpayer is required to settle with the town treasurer. Interest at the rate of 4% is allowed on local tax settlements and costs may be taxed against the unsuccessful party in the discretion of the board.[14] A comprehensive set of rules has been promulgated by the appellate tax board and its predecessor, the board of tax appeals, much of which has been the subject of litigation, both before the board itself and the courts. As result there is no dearth of precedent.

The board of tax appeals of Massachusetts was established in 1930[15] to consist of three members, including a chairman, later

[7] Rules 8 and 9, *ibid.*

[8] Rule 20, *ibid.*

[9] *Mass. G. L.*, c. 59, sec. 65; Rule 5, Mass. A. T. B.

[10] *Ibid.*, c. 58A, secs. 11 and 12.

[11] *Ibid.*, sec. 10; Rule 28, Mass. A. T. B.

[12] *Ibid.*, sec. 13; *West Boylston Mfg. Co.* v. *Assessors of East Hampton*, 277 Mass. 180, 178 N. E. 531.

[13] *Appendix to Rules*, Mass. A. T. B.

[14] *Mass. G. L.*, c. 58A, secs. 12 and 13.

[15] *Mass. St.* 1930, c. 416; *Mass. G. L.*, c. 58A.

increased to five members, designated by a governor with the advice and consent of the council. The name was changed to the appellate tax board in 1937.[16] Members are required to devote their entire time to the work of the board and serve for staggered terms of six years each. Not more than three members may be of the same political party. Compensation is fixed by the statute at $7,500 a year for chairman and $7,000 a year for members.[17] Independence of state tax administration is provided by the creating statute as follows:

> "There shall be in the department of corporations and taxation, but in no manner subject to the control of the commissioner of said department, an appellate tax board. . . ."[18]

The board is empowered to employ a clerk and other necessary employees and, subject to the approval of the governor and council, to fix their compensation, and to incur other necessary expenses.[19]

The present board consists of three lawyers, one real estate man and one merchant. The clerical staff comprises twenty-one persons receiving salaries aggregating $4,320.30 per month.[20]

Statistics covering the work of the board during the year ended Nov. 30, 1940 are of interest as an indication of the volume of work transacted. These figures include appeals from central assessments as well as local assessments. During the period mentioned the board decided 1,461 cases of all kinds and 5,667 pending appeals were disposed of without trial or decision. This ratio of nearly 4 to 1 may indicate a habit on the part of taxpayers of filing appeals without the intention of prosecuting them to conclusion. Since filing an appeal does not, under ordinary circumstances, stay the collection of the tax, it would appear that the advantage to the taxpayer would be purely tactical in dealing with the assessors.

There were 8,210 appeals entered during the year ended Nov. 30, 1940 and 7,128 disposed of in this period. The increase of 1,082 pending appeals at Nov. 30, 1940 brought the total number of cases awaiting trial or other disposition at that date to 11,976. The board decided 1,461 cases during the year, or an average of about five cases each working day. This average is roughly equivalent to one case a day for each member, and yet, on the basis of past experience, more than two years would be required to dispose of the cases pending at Nov. 30, 1940.

[16] *Mass. St.* 1937, c. 400.

[17] *Mass. G. L.*, c. 58A, secs. 1 and 2.

[18] *Ibid.*, sec. 1.

[19] *Mass. St.* 1937, c. 400, sec. 5.

[20] The data on employees and number of cases was furnished to the writer by Mr. Ernest W. Ricker, clerk of the Massachusetts appellate tax board in a letter dated Aug. 27, 1941.

It is reported that the board is upheld in 95 per cent of the appeals to the Supreme Judicial Court of Massachusetts. Such a record is perhaps equalled by few trial courts and is taken to indicate a very high standard of performance. The growing size of the docket must nevertheless be a source of real concern both to the board itself and the taxpayers and assessors.

Despite the six-year term of membership on the board there is a feeling in some quarters that a longer term of office or some other means of extending the tenure would be a desirable improvement in Massachusetts. It is manifest that such a board cannot become a haven for purely political appointees without serious consequences. The review powers exercised by the board are doubtless regarded by some as having political significance. While it appears that no change in the Massachusetts law is being considered at present, there seems to be a belief that some further steps toward removal of the board from political considerations are desirable and not far distant.

3. NEW JERSEY

New Jersey subjects realty, tangible and intangible personal property to property tax at the same rate. The taxing district, which may be a city, town, borough or any political subdivision less than a county, imposes taxes, subject to equalization and review by the county board of taxation.[21] The appeal by aggrieved taxpayers or taxing districts must be filed with the county board by Aug. 15, and such an appeal is necessary before further redress may be had.[22] Appeal may be made to the state board of tax appeals from the findings of the county board on or before Dec. 15.[23] The petition of appeal must conform to the rules of the board[24] and be accompanied by proof of service of a copy of the petition upon the county board and the county attorney, or upon the taxpayer if the appeal is by a taxing district.[25] An answer to the petition by the respondent is not required. That portion of the tax which is not contested by a taxpayer may be paid while an appeal is yet pending.[26] The board may refer an appeal to a single member for hearing and report,[27] and testimony may be taken by a commissioner or master in chancery.[28]

[21] *Revised Statutes of N. J.* 1937, Title 54, chap. 3.

[22] *Twp. of Blairstown* v. *Blair Academy* (1928), N. J. Tax Rep. 1912-1924, p. 415, affd. 6 N. J. M. 500, 141 A 789, 106 N. J. L. 606, 146 A 918.

[23] *R. S. of N. J.*, Sec. 54: 2-39.

[24] Rule IV, New Jersey Board of Tax Appeals.

[25] Rule V, *ibid.*

[26] *R. S. of N. J.*, 54: 3-27.

[27] *Ibid.*, 54: 2-18; Rule VIII, N. J. B. T. A.

[28] *Ibid.*, 54: 2-25 *et seq.*

Board hearings are open to the public and the findings of fact must be reduced to writing, which thereupon constitute a public record. The statute requires stenographic transcript of all testimony in cases involving more than $5,000 in tax.[29] The board may compel the production of books and witnesses[30] and punish for contempt.[31] Practice and procedure before the board are required to follow that prevailing in the state courts, but the board may modify rules in order to make procedure as informal as possible "to the end that substance and not form shall govern."[32] Judgments are entered in all cases except where appeal is withdrawn, and opinions are filed in cases involving questions of law and in important cases involving questions of fact.[33]

Judicial review of the board decision may be had by certiorari from the Supreme Court, which has the power to consider evidence and fix valuations.[34] This power seems to be sufficient to permit substantially a new trial in the Supreme Court.

The New Jersey state board of tax appeals was established in 1931[35] as an independent agency for the settlement of disputes arising from both central and local tax assessments. It consists of seven members appointed by the governor, by and with the advice and consent of the senate, for five-year terms. At least two members, including the president of the board, must be counsellors-at-law, and not more than four members may belong to the same political party.[36] The president is designated by the governor and receives a salary of $6,500 a year. The remaining members each receive $4,500 annually.[37] The board may hold hearings at places outside the capital[38] and has authority to employ clerical and technical assistants and, subject to civil service laws, to fix their compensation.[39]

Statistics are not available to show number of cases decided by the board and the condition of its docket. It appears that there were 26,066 appeals to the board during the calendar year 1940, of which

[29] *Ibid.*, 54:2-16.

[30] *Ibid.*, 54:2-17.

[31] *Ibid.*, 54:2-15.

[32] Rule XV, N. J. B. T. A.

[33] Letter to the writer from Mr. Chas. E. Cook, secretary, New Jersey state board of tax appeals, Aug. 29, 1941.

[34] *R. S. of N. J.*, 54:4-62; *City of Paterson* v. *Baker*, (1927) 5 N. J. M. 1075, 139 A 413.

[35] *R. S. of N. J.*, 54:2-1; *L.* 1931, c. 100, p. 166.

[36] *R. S. of N. J.*, 54:2-3; 54:2-4; 54:2-7.

[37] *Ibid.*, 54:2-8.

[38] *Ibid.*, 54:2-11.

[39] *Ibid.*, 54:2-12.

24,569 represented appeals from decisions of county tax boards on local assessments. The New Jersey board is thus preponderantly an agency for the review of local assessments.

4. OHIO

In Ohio the county auditor assesses real property and the smaller personal property taxpayers,[40] in the case of personal property acting as the deputy of the state tax commission.[41] This division of responsibility has necessitated the promulgation of extensive schedules classifying property used in various industries as real or personal. The county board of revision hears complaints and revises the auditor's assessments of real property [42] and the state tax commission does the same for personal property.[43] Taxpayers or county auditors may enter written appeals from findings of the county board of revision with the board of tax appeals within 30 days, or by December 31 of any year if the issue involves the exemption of property from taxation.[44] Appeals in respect of personal property are taken from the decisions of the tax commissioner to the board of tax appeals. The board of tax appeals may hold a hearing or determine the case from the record, sitting either in Columbus or in the county where the property is situated, and may assign the hearing to a single member.[45] The appeal and procedure must conform to the requirements of the board as set out in the rules which it has established.[46] There is no requirement in statutes or rules for an answer by the respondent. Procedure is invariably formal and all proceedings are stenographically reported and decisions written in full except in cases which are relatively unimportant.[47] The Supreme Court of Ohio has jurisdiction of appeals from decisions of the board of tax appeals.[48]

The Ohio board of tax appeals consists of three members appointed by the governor by and with the advice and consent of the senate. Two of the present members are attorneys and one a former auditor for the United States bureau of internal revenue. They receive salaries of $5,000 a year each and have a clerical staff of eight

[40] Income from productive investments of less than $500 or taxable property of less than $5,000. *Ohio G. C.*, sec. 5548.

[41] *Ohio G. C.*, secs. 5372-3, 5376.

[42] *Ibid.*, sec. 5609.

[43] *Ibid.*, sec. 5394.

[44] *Ibid.*, sec. 5610.

[45] *Ibid.*, sec. 5611.

[46] *Rules and Regulations of the Board of Tax Appeals of the Dept. of Taxation of Ohio.*

[47] Letter to the writer from Mr. Hugh S. Jenkins, chairman, board of tax appeals of Ohio 9/8/41.

[48] *Ohio G. C.*, sec. 5611-2.

persons whose compensation amounts to $17,400 per year.[49] The board has authority to appoint a secretary and other clerical assistants and to prescribe their duties and compensation.[50] The board succeeded to the review functions of the tax commission of Ohio when the latter was abolished.[51]

The board has exercised remarkable dispatch in clearing its docket. When it was established there were 1941 appeals pending.[52] In the period from June 5, 1939 to July 1, 1941, 3,956 additional appeals were filed with the board and it succeeded in disposing of no less than 4,747 cases. Of the cases thus determined 1,902 were tried and decided and 2,805 were disposed of in other ways. It is of interest that the conclusion of these causes was 3,015 in favor of the revenue and 1,732 for the taxpayer. 1,150 cases were on the docket on July 1, 1941.

In the period June 5, 1939 to July 1, 1941 only 20 appeals (all by taxpayers) were taken from the board decisions to the Ohio Supreme Court. In the 10 Supreme Court decisions rendered to Sept. 8, 1941 on these appeals, the board was sustained seven times and reversed three.

5. OTHER STATES

While only Massachusetts, New Jersey and Ohio have independent boards of review for local property taxes, other states have similar boards with reviewing power over centrally determined assessments. It is pertinent to consider these states briefly, as such boards have much in common with the three we have discussed. Procedure is generally similar to Massachusetts (formal) and New Jersey.

Wisconsin's board of tax appeals was instituted in 1939 and is "Subject to the provisions for judicial review, . . . the final authority for the hearing and determination of all questions of law and fact arising under the tax laws of the state, except such as may be otherwise expressly designated." [53] However, it appears that the board is not empowered to review local assessments. There are three board members, all attorneys, who receive $5,000 annual salaries each, and their clerical staff of three is paid $6,360 a year.[54]

[49] Letter of Mr. Jenkins, *supra*.

[50] *Ohio G. C.*, sec. 1464-1.

[51] *Ibid.*, sec. 1464.

[52] Figures on number of cases decided which follow are from Mr. Jenkin's letter, *supra*.

[53] *Wis. Stat.*, ch. 73, sec. 73.01 (5).

[54] Information relative to volume of work, etc. is from a letter to the writer from Mr. W. J. Conway, chairman, Wisconsin board of tax appeals, Aug. 28, 1941.

They docketed 594 appeals in the period Oct. 18, 1939 to Aug. 1, 1941, and decided 121 cases; 363 cases were dismissed following stipulation. The docket at Aug. 1, 1941 contained 110 cases. Taxpayers appealed from the board in 38 cases and the revenue administration in 9. The high court had disposed of 16 of these appeals with the score: sustaining board 11, reversing board 2, otherwise disposed of 3. Appeals to the board involved 349 personal income and 98 corporation income tax cases, 93 corporation privilege tax matters, 44 on estates, inheritances and gifts, and 10 on utilities.

The Lousiana board of tax appeals was created in 1934 for the purpose of hearing appeals on income tax matters.[55] The 1940 governmental reorganization plan changed the name to the board of revenue and transferred to it the duties of the Louisiana tax commission, including equalization and review of revenue department acts and ". . . power to order the correction of errors and inequities in the collection of taxes for State purposes."[56] The Supreme Court of Louisiana indicated these changes to be unconstitutional in July 1941,[57] and the board of tax appeals thereupon resumed its operations in respect of income tax matters only. Of the three present members, two are attorneys and one a certified public accountant, who serve at annual salaries of $5,000 for members and $6,000 for the chairman.[58] The clerical staff of four receive salaries aggregating $9,900. The docket at June 30, 1941 (income taxes only) contained 44 cases, and during the twelve months preceding 45 appeals were entered, 41 decided and 21 disposed of by agreement without trial. The revenue received 31 favorable decisions and the taxpayers 10, but one taxpayer appealed from the board's decision, only to lose his case in the high court.

The Pennsylvania board of finance and revenue consists of the state treasurer as chairman, the attorney general, the auditor general, and the secretary of revenue, all ex-officio.[59] It has the power to revise any settlement made by the department of revenue, the department of the auditor general and the treasury department, but no authority relative to appeals from local property assessments.[60]

The Delaware state tax board has jurisdiction over complaints arising from department of revenue findings as well as from the

55 La. Act 21 of 1934.

56 La. Act 47 of 1940.

57 *Earl R. Graham et al.* v. *Sam H. Jones et al.*, No. 36,159, Supreme Court of La.

58 The information relative to volume of work, etc. was supplied by Mr. J. C. Pearce, secretary of the board of revenue, in a letter to the writer dated Sept. 10, 1941.

59 Penna. 71 *P. S.*, sec. 115.

60 Penna. 72 *P. S.*, secs. 501, 502.

secretary of state determinations in respect of capital stock (franchise) tax assessments. It also has the duty of deciding upon policy questions submitted to it by the tax commissioner and fixing the salaries of the tax commissioners' appointees. No jurisdiction over local property taxes exists.[61]

The corporation tax appeal board of Michigan instituted in 1921 (attorney general, state treasurer and auditor general, ex-officio) has no regular staff and is limited in jurisdiction to appeals from the corporation and securities commission in respect to the corporation privilege (franchise) tax.[62] Since inception it has tried 75 cases with only 3 decisions favorable to the taxpayer.[63] In 30 appeals to the Michigan Supreme Court the board has been reversed but once. No appeals were entered in the twelve-month period ended August 31, 1940.

The Minnesota board of tax appeals, established in 1939, has no jurisdiction of local taxes and is authorized only to review orders or decisions of the tax commissioner.[64] Its present membership comprises one former member of the tax commission and two lawyers, who receive a per diem of $25, not to exceed $2,500 a year for their services.[65] It has only one employee. During the period August 1, 1939 to August 30, 1941 there were 70 appeals to the board, of which 18 were tried and decided (6 for revenue, 12 for taxpayer) and 25 otherwise disposed of. At August 30, 1941, 27 cases remained on the docket. During the same period revenue and taxpayers each appealed three decisions of the board. The only case yet decided by the appellate court has upheld the board.

The South Carolina tax board of review, created in 1916, is limited in jurisdiction to review of the acts of the tax commission, relating either to an original assessment or an increase in assessments originally made by boards of assessors. The seven appointive members (four merchants, a banker, a textile executive and a lawyer) receive a per diem of $5.00 and mileage. The appropriation for the board is $580. Any person affected may appeal, and the tax board of review may modify, reverse or affirm the action of the tax commission.[66] Only one appeal was entered and decided (in favor of the taxpayer) by the board during the year 1940.[67]

[61] *Del. R. C.*, sec. 154.

[62] *Mich. C. L.* 1929, sec. 10,145.

[63] Letter of Mr. Howard M. Warner, commissioner, Mich. corporation and securities commission, dated Sept. 12, 1941.

[64] *Minn. L.* 1939, c. 431, Art. VI, sec. 14.

[65] The information relative to volume of work, etc. is from a letter of Mr. Herbert Southworth, clerk of the board of tax appeals of Minnesota, to the writer, dated Sept. 3, 1941.

[66] *S. C. Cd.* 1932, sec. 2432.

[67] Letter to the writer from Mr. Walter G. Query, tax commissioner of South Carolina, Sept. 10, 1941.

A Georgia board of tax appeals was established Jan. 3, 1938 but with powers limited to review of individual assessments and equalization as made by the commissioner of revenue.[68] The board tried a number of income tax cases but only one property tax matter, in which it was upheld upon appeal. It was practically abolished by the 1941 General Assembly which limited its jurisdiction to assessments by the revenue commissioner for ad valorem taxes.[69]

6. CONCLUSION

Experience indicates that taxpayers have definitely accepted the means of redress of assessment grievances afforded by boards of review. Indeed, the enthusiasm of the local property taxpayers' acceptance in Massachusetts and New Jersey, for example, as evidenced by the number of appeals entered, is positively embarrassing in volume, and facilities afforded by the boards for disposing of cases seem more than completely utilized.

It would be interesting to compare the number of appeals to a board of review with the number of tax appeals to the courts before organization of the board. So far as known, the only such comparison available was made by Mr. Jo V. Morgan, member sole of the District of Columbia board of tax appeals, in an address before the tax clinic of the American Bar Association in March 1940. Mr. Morgan said that the District of Columbia board handled approximately 200 cases a year, on the average, during the first months of its existence. Before that time, when the District board was not available to taxpayers, there were only about six tax cases a year filed in the courts. One may conclude from the District of Columbia experience that taxpayers will take their grievances before a board of review with much greater alacrity than they will submit them to a law court. Definite figures are not available, but it hardly seems likely that as many as 26,000 tax cases a year were filed in New Jersey courts before the New Jersey board of tax appeals was created, or that the Massachusetts courts had to deal with 8,200 tax appeals each year before the appellate tax board commenced to function. Without doubt both Massachusetts and New Jersey must have experienced a very large increase in tax litigation with the creation of their review boards.

If this is the case and if litigation (including board cases in the term) is increased, what justification is there for the board of review. Why increase the complexity and cost of state government, as some would put it, by adding another agency. Why force the local tax districts to appear in a newly created forum and compel them to defend each assessment questioned by any disgruntled taxpayer and thus further imperil the revenue from the local property tax.

[68] *Ga. Laws* 1937-8, Ex. Sess., No. 296, ch. III.

[69] *Ga. Laws* 1941, No. 344.

These questions are the gist of the argument against the board of review. It is interesting that each point, complexity, cost, coercion of local governments, and the perilous state of local property taxes, has its counterpart in arguments on the other side. It is axiomatic that assessment practice of a century ago, which has not by any means disappeared, is completely inadequate today. The machinery for property tax administration must be geared to an industrial civilization. We must understand that relatively complex property requires adequate assessment and review, and that this may involve organization changes.

We must also recognize that state aid to local governments is now definitely accepted, not only in more advanced communities but in the hinterland. A board of review is primarily a manifestation of this state aid. To the advocates of home-rule who say that state aid should be pure largess without supervision or strings, the board of review proponents would reply that here the problem of direct local revenues is involved and the presence of a board would permit the levy of local property taxes at much higher assessment levels. By providing relief at the points of greatest pressure, the community could bear higher taxes without distress. More efficient local property tax administration will, by definition, produce greater revenues at any given level, and boards of review provide a practical means of toning up assessment practice and thus go to the root of the problem. Considerable sums are now being spent by many states at the other end of the line in training and supervising local assessors. A board of review provides a practical means of checking local assessment performance. Much of the doubt and uncertainty over the future of local property taxes might be resolved by creating a board of review.

Arguments such as these on both sides are doubtless heard when it is proposed to introduce a state board of review for local taxes. Whether such boards are generally desirable may not be answered categorically. One may question whether there has been sufficient experience upon which a conclusion may rest. One may feel concern over the very large number of appeals and the physical ability of boards to handle them. Equal or greater concern, on principles of common justice, may be felt for the taxpayers in states which have no boards. Why do they flock in such numbers to boards of review and remain uncomplaining in the absence of such boards. A completely satisfactory answer to this question is not yet available, and when it is, we shall doubtless know whether a board is to be regarded as a permanent and regular feature of administration, and a considerable amount about the structure and methods of the ideal board as well. For the present the board of review for local taxes is a mechanism which certainly deserves extended trial, and gives promise of furnishing a new and invaluable means of improvement in the administration of local property taxes.

CHAIRMAN SCOTT: Dr. Jo V. Morgan is Professor of Law of Taxation at Southeastern University, Washington, D. C. He holds a rather unique position as a one-man Board of Tax Appeals in the District of Columbia. This board was established in May of 1938, and the original act which created the Board of Tax Appeals provided for three members. For reasons of economy, it was cut to one member without changing the name, so that is how it comes that while the name of the agency is "Board of Tax Appeals," there is only one member of it. That member is Dr. Morgan, who will now treat the subject of "Board of Review," from both a multiple member and a single member board.

BOARD OF REVIEW: SINGLE MEMBER

JO V. MORGAN
Member Sole, Board of Tax Appeals for the District of Columbia, and Professor, Southeastern University

On the several occasions at which I have been called upon to discuss the Board of Tax Appeals for the District of Columbia I have been embarrassed, as I now am, by the fact that I conceived the Board, drafted the legislation establishing it, promoted the passage of such legislation, and became, and still am the sole member thereof. Fairness requires the warning that what I have to say about the Board will no doubt be tinged with prejudice, and that any statements laudatory of it or its structure or operation should be, for that reason, closely scrutinized.

TAX STRUCTURE OF THE DISTRICT OF COLUMBIA

Perhaps, at this point and before any further discussion of the Board of Tax Appeals, there should be presented for the purpose of comparison a picture of the tax structure of the District of Columbia. In round numbers it is the following:

Kind of Tax	Assessed Valuation	Amount of Tax
Real Estate, Total	$2,083,000,000	
Less Exemption	853,000,000	
Net	$1,230,000,000	$21,600,000
Personal Property, Automobile	93,000,000	1,620,000
Other Personal Property	70,000,000	1,200,000
Franchise, Public Utilities and Banks		2,205,000
Income { Corporation		2,044,000
Income { Individual		1,819,000
Inheritance and Estate		800,000
Gasoline		3,000,000
Insurance Premiums		800,000
Alcoholic Beverage		2,300,000

Reason for Establishment

The Board of Tax Appeals was designed to remedy a situation in the District of Columbia very unfair to taxpayers who questioned the validity of tax assessments. Our appellate court had but recently decided that the assessment and collection of a tax could not be enjoined by court of equity, and that the only remedy was the payment of the tax under duress and a suit at law to recover it.[1] "Duress" was interpreted to mean immediate threat of loss or injury to the property or person of the taxpayer.[2] Since the Collector of Taxes was personally liable for any misstep in the process of collection he was very loath not only to distrain or even to threaten to distrain or to take any step toward collection, and the taxpayer had the unhappy choice of paying the tax voluntarily or permitting interest to accumulate at the 1 per cent a month. Even if he could have succeeded in placing himself in jeopardy and the amount involved was sufficient to file suit and pay a lawyer's fee, several years would have elapsed before the case would be tried, and then, should he be successful, he would have to wait until Congress appropriated money to pay the judgment.

Jurisdiction

The jurisdiction of the Board of Tax Appeals extends to all matters of taxation in the District of Columbia, including real estate, personal property, income, inheritance, estate, business privilege, public utility and banking franchise, gasoline and insurance premium taxes, and penalties and interest thereon.

In every instance the taxpayer must first pay the tax under protest in writing and file his appeal within the statutory period, which is generally 90 days from the date of the assessment. The sole purpose of the written protest is to warn the assessing authority that a contest is to be expected and to caution him to retain all supporting documents and to prepare for the defense of the assailed assessment.

Procedure

Proceedings before the Board are initiated by the filing of a simple petition alleging the necessary jurisdictional facts, the errors claimed to have been committed by the assessing authority and the facts upon which such claim is based.[3] No filing fee is required.[4] A copy of the petition is served on the assessing authority by the clerk

[1] *Maryland & Virginia Prod. Assn.* v. *D. C.*, 66 App. D. C. 136, 85 F(2d) 302 (1936).

[2] *Blanks* v. *Hazen, et al.*, 66 App. D. C. 118, 85 F(2d) 284 (1936).

[3] Rule 6 and Appendix A, *Rules of Procedure, Board of Tax Appeals, D. C.*

[4] *Ibid.*, Rule 8.

of the Board.[5] All material allegations are deemed to be denied by the District of Columbia, and no answer is required unless the District seeks some affirmative action, such as, for instance, the increase of the tax.[6] If an answer is filed, issue is joined immediately, otherwise at the end of 20 days from the date of the filing of the petitioner.[7] Upon the joinder of issue the clerk sets the case for hearing upon 10 days' notice.[8] In a vast majority of instances hearings are had within 30 days from the initiation of the proceedings.

The hearings before the Board are informal but orderly. If insisted upon by either party, the rules of evidence apply.[9] The testimony of witnesses is taken down stenographically and copies of the transcript are supplied to petitioners at very low rates. The taxpayer may appear in proper person or by counsel, and the District of Columbia by the assessing authority or by the Corporation Counsel.[10] Very few hearings last longer than one-half hour. This is due to the fact that in most instances it is the law and not the facts that are in dispute, and to the disposition of counsel to admit all facts not in dispute. The Board is required to hear and determine all questions arising on the appeal, and to make separate findings of fact and conclusions of law and render a decision therein in writing. The Board may affirm, cancel, reduce, or increase assessments.[11] "Any sum *finally* determined by the Board to have been erroneously collected from the taxpayer shall be refunded by the District to the taxpayer. . . ."[12] Generally, a successful taxpayer receives the refund found to be due him in from 60 to 75 days from the initiation of the case, unless, of course, the District of Columbia or the taxpayer appeals from the decision of the Board to the United States Court of Appeals for the District of Columbia, in which event the decision of the Board does not become final until affirmed.

The functions of the Board are almost entirely judicial and not administrative, except, perhaps, its power to increase assessments. The Board renders its decisions entirely upon the documentary and oral evidence before it. Every finding of fact should be supported by the record. The law would seem so to demand, since the parties have the right to appeal to the Court of Appeals.

5 *Ibid.*, Rule 10. The Assessor is the assessing authority as to all taxes, except insurance premium taxes, as to which the Superintendent of Insurance is the assessing authority.

6 *Ibid.*, Rule 11.

7 *Ibid.*, Rule 12.

8 *Ibid.*, Rule 23.

9 *Ibid.*, Rule 27(a).

10 *Ibid.*, Rule 3.

11 *Ibid.*, Section 3, Title IX, D. C. Rev. Act of 1937, as amended by act of May 16, 1938.

12 *Ibid.*, Section 7.

Advantages

I have been somewhat surprised at the comment which has been occasioned by the establishment of the single member Board of Tax Appeals for the District of Columbia. Less sympathetic commentators have called the Member Sole everything from Charlie McCarthy to Adolph Hitler. I believe it is a question of nomenclature. If it were called a "court," as it really is, its single member feature would be understood. Viewing it, however, as an administrative board it is hard to understand why the lawyers, at least, find anything unusual, when it is known that one of the most successful, if not the most successful, administrative boards in the District of Columbia is single-membered. I refer to the Deputy Employment Compensation Commissioner who alone hears all employees compensation cases, makes findings of fact, conclusions of law and renders his decisions, the vast majority of which are affirmed by the courts. The same is true concerning the many deputy commissioners who act throughout the country under the Longshoremen and Harbor Workers Compensation Act.

The Federal Board of Tax Appeals, while it has many members, is practically a single-membered body as far as a large majority of cases are concerned. Generally, one member hears and disposes of one case. Of course, in unusual and very important cases the decisions of the single member may be, at the discretion of the chairman, referred to the full Board; but in such instance the reference is a review, and the decision when promulgated carries on its face the legend "Reviewed by the Board."

It should not be overlooked, moreover, that in a great many instances, where a body or tribunal is multiple-membered and there is a division of opinion, one member really decides the controversy.

There is, I believe, another thing that is fruitful of misunderstanding or lack of appreciation of the advantages of a single-membered tax appellate body. It is the confusing of the proper scope of activities of a state tax commission with the functions of a board of tax appeals or tax court—call it what you may. Legislatures have frequently fallen into that error.[13] The sphere of the state tax commission is, or ought to be, restricted to state-wide, and, perhaps, local equalization, and to the control or supervision of the purely administrative side of the assessment of taxes. A board of tax appeals should be quasi-judicial, at least, and independent functionally of the assessing authority and of the executive branch of the

[13] The State Tax Commission of Maryland is an example. It exercises the usual functions of a state tax commission and of a tax appeals body or court. Moreover, it acts as a state corporation commission. The Attorney General not only represents the state as appellee in tax appeal matters, but is also counsel for the State Tax Commission and advises them as to their decision on the appeal.

state, before which the state and the taxpayer appear on an equal footing and where a taxpayer may have the validity of the assessment against him determined as a matter of law.

In March 1940 I had the honor to appear before the Tenth Tax Clinic of the American Bar Association and explain the Board of Tax Appeals for the District of Columbia.[14] Concerning the single-member feature of the Board I there gave the view I then, and still do entertain, as follows:

> "It has been suggested that the Board should have three or more members. I am not going to deceive myself into believing that I can discuss such suggestion entirely disinterestedly or without prejudice, and do not suppose that you will overlook the fact that I am the Member Sole of the Board. I hope that I will not be considered too indelicate or a disciple of Heraclitus [15] when I say that I can not agree with such suggestion. To increase the membership of the Board to three or five members, all of whom would hear each case, would make it unwieldy and would justify, or, at least, give color to Carlyle's criticism of departments, boards and other agencies of Democracy that they have 'none of the alertness of getting along with the business.' [16] The necessity of discussion of findings and opinions and agreement thereon among the members would so retard the functioning of the Board that its usefulness would be greatly lessened, if not destroyed. It is far better to employ the money available for salary in the employment of one capable man than to divide it among three mediocre ones. The success of the Board, like the success of so many similar bodies, depends upon the selection as a member a capable and experienced tax practitioner. The salary should be sufficient to compensate such person adequately and to tempt him to accept the post. It must be kept in mind, moreover, that there is always an appeal from the decisions of the Board. What has been said, however, should not be taken to mean that, if the business of the Board should so increase that one member could not adequately perform its functions, additional members should not be appointed, each to preside over distinct sections or divisions of the Board, as is done in the Federal Board of Tax Appeals, which is quite different from the proposal that all the members of the Board hear and determine all of the proceedings before it."

[14] *Taxes—The Tax Magazine*, May 1940, pp. 297, *et seq.*

[15] "To me, one is ten thousand, if he be the best." — (One hundred and twelfth fragment of Heraclitus of Ephesus.)

[16] *Carlyle—Past and Present.*

In my remarks from which the foregoing is taken I discussed the feasibility and practicability of set-up of the Board as a local board of tax appeals for the determination of the validity of state, county and municipality taxes.[17] To repeat the outline I there made would extend this discussion unduly, and I must content myself with referring those who may be interested to what I there said. I ought to say, however, that I believe that boards of tax appeals or tax courts similar in structure and procedure of that of the Board of Tax Appeals for the District of Columbia would be not only practicable but successful in the states. That it has been successful in the District of Columbia is evidenced by two facts. Before the Board was established there was a yearly average of six cases involving the validity of taxes filed in all our local courts, but in the three years in which the Board has functioned five hundred appeals from assessments have been filed before it. About a year ago it was suggested that the Board be abolished and its functions transferred to the Assessor's office or to the Corporation Counsel. Promptly twenty-three civic organizations, such as the Bar Association, Federation of Citizens Associations, the Board of Trade, and accountants' associations appeared before the Commissioners of the District of Columbia and so vigorously opposed such proposed abolition that the plan was abandoned.

And finally, let me say what I have said before:[18] The three essential features of the Board of Tax Appeals for the District of Columbia are (1) the complete separation of the Board and the agency that represents the District of Columbia which might loosely be called the prosecutor; (2) the right of the District of Columbia to appeal to the Court of Appeals from the decision of the Board, which has the effect, psychological as it may be, of promoting fair and impartial decisions; and (3) a fund in existence from which may be refunded the taxes declared by the Board to have been erroneously collected. As long, and only so long as it has those features it will be a success.

[17] *Taxes—The Tax Magazine*, May 1940, pp. 300, 301 and 309.

[18] *Ibid.*, p. 300.

FOURTH SESSION

MONDAY, OCTOBER 13, 2:40 P. M.

Ballroom, Lowry Hotel

Charles W. Gerstenberg, presiding.

CHAIRMAN GERSTENBERG: You know, of course, that there are two sessions this afternoon, and in order that everybody may feel that he is in the right pew as well as the right conference, our meeting here in the ballroom is on recent Supreme Court and other court decisions. You will remember that in some years we have had those papers combined in one paper. This year we have four papers, and I think that perhaps we had better get through the papers before we go into the discussion.

The first paper is entitled "The Taxing Power of the States as Affected by the Commerce Clause and Due Process Clause of the 14th Amendment." That paper will be delivered by Mr. Walter F. Dodd, of Dodd & Edmonds, of Chicago. I have great pleasure in introducing Mr. Dodd.

RELATION OF DUE PROCESS AND COMMERCE CLAUSE TO STATE TAXING POWER, 1940–41

WALTER F. DODD

Attorney, Chicago

This paper is limited to decisions of the United States Supreme Court at its 1940 term extending from October, 1940 to June, 1941. It has been the practice of this Association to have annual reviews of these decisions, and for the previous year information may be obtained from papers presented at your 1940 meeting by Thomas Reed Powell and Fred Rodell. Perhaps it is both to your interest and to mine that there were fewer cases affecting state taxation at the 1940 term of the United States Supreme Court, and that I can therefore summarize them more briefly than was possible in the entertaining papers of last year.

It is appropriate that your program for this year unites the tasks of discussing cases under both the due process and commerce clauses. The case of *Nelson* v. *Sears, Roebuck & Co.*,[1] perhaps the most important case affecting the commerce clause, also presents a due

[1] 312 U. S. 359 (1941).

process issue and relies largely on *Wisconsin* v. *J. C. Penney Co.*,[2] the most important case under the due process clause.

The decisions of the 1940 term must of course be considered in the light of prior decisions and particularly in the light of the two highly important recent decisions of *McGoldrick* v. *Berwind-White Coal Mining Co.*,[3] in 1940, and *Curry* v. *McCanless*,[4] in 1939. With reference to both the due process and commerce clauses we can perhaps adhere to only one principle, that "logic and taxation are not always the best of friends", stated by Mr. Justice McReynolds in concurring with the opinion in *Sonneborn Bros.* v. *Cureton*.[5] With reference to commerce Mr. Justice (now Mr. Chief Justice) Stone properly indicated in the *Berwind-White Coal* case that there was little of definite principle but that "the decisions appear to be predicated on a practical judgment as to the likelihood of the tax being used to place interstate commerce at a competitive disadvantage."

And as to multiple taxation of intangibles we have the announcement by the same judge in *Curry* v. *McCanless* that any state may tax one who brings "his person or property within the reach of the tax gatherer there." This statement is now supplemented by the more general statement in *Wisconsin* v. *J. C. Penney Co.*[6] that: "The simple but controlling question is whether the state has given anything for which it can ask return." The application of the principle in the *Sears, Roebuck* case indicates that there is no necessary relation between what is given and what is sought in return.

The United States Supreme Court has left a wide range of tax freedom to the states, and some members of the court who may now join with others to constitute a majority are of opinion that judicial restraint upon the states should be removed and that Congress should "devise a national policy fair alike to the states and our union." Black, Frankfurter and Douglas, JJ., dissenting in *McCarroll* v. *Dixie Greyhound Lines*.[7] From the unanimous opinions in *Hale* v. *Bimco Trading*[8] and *Best & Co.* v. *Maxwell*[9] it is clear that the court is not yet willing to surrender all of its power to Congress; but the decisions already rendered indicate a necessary trend toward a national tax policy devised by Congress with respect both to com-

[2] 311 U. S. 435 (1940).

[3] 309 U. S. 33 (1940).

[4] 307 U. S. 357 (1939).

[5] 262 U. S. 506 (1923).

[6] 311 U. S. 435 (1940).

[7] 309 U. S. 176, 189 (1940).

[8] 306 U. S. 375 (1939).

[9] 311 U. S. 454 (1940).

merce and to multiple taxation, and such a policy will be expedited unless the states exercise a restraint which can hardly be expected of humans.

Of the cases decided at the 1940-41 term of the United States Supreme Court, some are without opinions, *Stewart* v. *Pennsylvania* [10]—one of the most important in the field of jurisdictional due process—is in this group. Three cases in which there are opinions may be classed as cases based on the commerce clause; three may be classified as cases under the due process clause, and in one of these there is merely a brief per curiam statement on the basis of which appeal is dismissed for want of a substantial federal question; four may be classified as combining the commerce clause and the due process or equal protection clauses, although in one of them the opinion is summary and is based on an opinion in another case handed down at the same time. The case of *Wisconsin* v. *Penney Company* finds basis in the due process clause, but reliance was unsuccessfully sought to be placed on the commerce clause in *Wisconsin v. Minnesota Mining & Manufacturing Co.*,[11] decided at the same time and involving the same Wisconsin statutes. But we are concerned with the results, and not with the constitutional clauses.

Jurisdiction to tax intangibles involves the due process clause. You are familiar with the earlier doctrine which justified multiple taxation of intangibles, and which was to some extent offset by the movement for reciprocal state laws; and you are equally familiar with the development of the principle that intangibles had only one situs for purposes of taxation. *Farmers Loan & Trust Co.* v. *Minnesota*.[12] But you are even more familiar with *Curry* v. *McCanless* [13] and *Graves* v. *Elliott*,[14] in which the court has determined that due process of law does not forbid multiple taxation of intangibles, but substantially that they are taxable wherever "within the reach of the tax gatherer." Each may levy and collect its tax if the property is "sufficient to answer the claims of both", and the court has called attention to the undisputed fact that "where there is no agreement or compact between the states having constitutional sanction", reciprocal legislation confers no contractual rights and is at any time subject to repeal. *Massachusetts* v. *Missouri*.[15]

With respect to corporate intangibles, you are also familiar with *Newark Fire Insurance Co.* v. *State Board of Tax Appeals*,[16] in

[10] 312 U. S. 649 (1941).

[11] 311 U. S. 452 (1940).

[12] 280 U. S. 204 (1930).

[13] 307 U. S. 357 (1939).

[14] 307 U. S. 383 (1939).

[15] 308 U. S. 1 (1939).

[16] 307 U. S. 313 (1939).

which four members of the court—who may now join with others to constitute a majority—took the position that the state of incorporation may tax all corporate intangibles although some or all of such intangibles may have a taxable "commercial domicile" elsewhere. *Wheeling Steel Corporation* v. *Fox.*[17]

Stewart v. *Commonwealth of Pennsylvania*[18] is an important case upon the taxation of intangibles, although the court found it proper to rely upon *Curry* v. *McCanless* and *Graves* v. *Elliott*, without writing an opinion. Changing personnel of the court reduced the dissenters to three—Hughes, McReynolds and Roberts. *Curry* v. *McCanless* appeared to rely in part, at least, upon the fact that there was "a general power of appointment, of which the testatrix here was both donor and donee", and upon the argument that this constituted a sufficient basis for taxation in Tennessee where the decedent was domiciled. The court said that "no comparable right or power resided in the beneficiaries upon whom a tax was sought to be levied in *Safe Deposit & Trust Co.* v. *Virginia.*"[19] Similar facts existed and are set out in *Graves* v. *Elliott*. In *Stewart* v. *Commonwealth of Pennsylvania*, the trustees were residents of New York, the stocks and bonds held by the trustees were kept in New York, and the beneficiary of the trust resided in Pennsylvania. It was stipulated that the "appellant (Pennsylvania beneficiary) has no control over the securities, no power to supervise investments, no remainder interest in the trusts, and was granted no rights under the deeds other than the right to receive the net income during her life." Although there may be other distinguishing facts, a decision without opinion sustaining the Pennsylvania tax indicates that limitations implied in *Curry* v. *McCanless* and *Graves* v. *Elliott* are of little if any force.

With respect to the question as to whether property is within a state for purposes of taxation, the most important opinion at the 1940-41 term of the United States Supreme Court is *Wisconsin* v. *J. C. Penney Co.*[20] The *Penney* case was in this respect held controlling, without argument, in *Wisconsin* v. *Minnesota Mining & Manufacturing Co.*[21] The commerce clause was also invoked in the *Minnesota Company* case, but was summarily disposed of on the ground that the state tax was imposed upon corporate net income "attributable to earnings within the taxing state."

In the *Penney* case the court sustained a Wisconsin tax on the privilege of declaring and receiving dividends by foreign and local

[17] 298 U. S. 193 (1936).

[18] 312 U. S. 649 (1941).

[19] 280 U. S. 83 (1929).

[20] 311 U. S. 435 (1940).

[21] 311 U. S. 452 (1940).

corporations, such tax, in the case of corporations doing business within and without the state, "to apply only to dividends declared and paid out of income derived from business transacted and property located within the State of Wisconsin." Foreign corporations remained subject also to a general corporate income tax on earnings attributable to their Wisconsin activities, and this tax had been sustained in *U. S. Glue Co.* v. *Oak Creek*.[22] The court clearly stated the result of the new tax:

> "The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out."

The chief objection to the tax was that the corporate net income of a foreign corporation is forwarded to the out-of-state office; dividends are declared outside the state and are distributed to stockholders who are not residents of Wisconsin. Upon these facts, Mr. Justice Roberts, with the concurrence of Chief Justice Hughes and of Justices McReynolds and Reed, was of the opinion that "the tax is levied on what lies outside the sovereignty of Wisconsin."

Although much of the language in the opinion of the court is unnecessary and unduly cumbersome, the result appears to be correct. Wisconsin could have imposed a higher income tax on net income derived from business in Wisconsin, and it may properly obtain the same result by two taxes, one on all net income earned in Wisconsin, and one on the portion of such income as is applied to dividends. The court properly says that the fact that a tax is contingent upon events without the state is not controlling. The tax is upon earnings within the state which are applied to payment of dividends.

We may turn now with some relief to a case in which there were no dissents but which leaves one in a mist. *Continental Assurance Company* v. *Tennessee*,[23] involved a suit brought by the state "to enforce payment of privilege taxes measured by premiums on policies of insurance issued while appellant was doing business within the state, but upon which the premiums were paid after its withdrawal from the state." The Supreme Court of Tennessee sustained the tax on the ground that it "was levied upon the privilege of entering the state and engaging in the insurance business, and not upon the annual premiums." In a brief per curiam opinion dismiss-

[22] 247 U. S. 321 (1918).

[23] 311 U. S. 5 (1940).

ing the appeal for the want of a substantial federal question, the court said that the construction of the statute by the state court distinguished it from that in *Provident Savings Life Assurance Society* v. *Kentucky*,[24] in which Mr. Justice Hughes, speaking for a unanimous court, held that it was not within the power of the state "to treat the mere continuance of the obligation of the existing policies held by resident policy holders as the transaction of a local business justifying the imposition of an annual privilege tax in the absence of the actual conduct of business within the limits of the state." In each case premiums on unmatured policies were paid by mail to offices outside the state. The present view of the United States Supreme Court appears to be proper, and the court wisely limits itself to a mere statement that there is a distinction from the earlier case. The process of distinguishing cases that are not distinguishable is one of the most serious vices of the courts. The brief opinion in the *Tennessee Insurance* case has already been several times cited as authority, twice in the case of *Wisconsin* v. *Penney*.[25] In *Department of Treasury of Indiana* v. *Wood Preserving Corporation*,[26] Mr. Chief Justice Hughes cited it in support of a statement that respondent in that case could not escape a tax "by arranging to have the proceeds of its intrastate transactions paid to it in another state."

We may now consider two cases arising under the Indiana Gross Receipts Tax, based upon the commerce clause, and in which there were no dissents. Mr. Chief Justice Hughes wrote the opinions in both cases. *Department of Treasury of State of Indiana* v. *Wood Preserving Corporation*[27] involved a tax on receipts derived from sale of untreated ties in Indiana. The sales were by mail or telephone from Ohio and the ties sold and delivered in Indiana were forthwith loaded on railroad cars for treatment in Ohio. The ties were produced in Indiana. The Wood Preserving Corporation purchased ties approved by an inspector of the B. & O. R. R., and the ties approved by the inspector were at once sold and delivered to the railroad. The court held that the transactions were local and none the less intrastate because the ties were at once loaded on cars to go to Ohio for treatment. The tax was on receipts "derived from sources within the state", and the case was properly distinguished from *Adams Manufacturing Co.* v. *Storen*[28] on the ground that "there the tax applied to gross receipts derived by an Indiana corporation from sales in other states of goods manufactured in

[24] 239 U. S. 103 (1915).

[25] 311 U. S. 435 (1940).

[26] 313 U. S. 62 (1941).

[27] 313 U. S. 62 (1941).

[28] 304 U. S. 307 (1938).

Indiana." The *Wood Preserving Corporation* case is not subject to criticism and requires no comment except that it supports Chief Justice Hughes' dissenting statement in *McGoldrick* v. *Berwind-White Coal Mining Co.*,[29] that: "If New York can tax the delivery, Pennsylvania can tax the shipment and New Jersey the trans-shipment."

Department of the Treasury of Indiana v. *Ingram-Richardson Manufacturing Co.*[30] involved a tax on the gross receipts of a company engaged in enameling stove and refrigerator parts at its plant in Indiana. The parts were transported from without the state for enameling and were returned to factories without the state after the completion of the enameling process. The court held that the gross receipts were taxable by Indiana and that: "The transportation of the metal parts to and from Indiana were but incident to that intrastate business." The court properly distinguished the case from *Gwin, White & Prince* v. *Henneford*,[31] where the entire service was in aid of interstate and foreign commerce.

When the state imposes a clearly discriminatory burden on interstate or foreign commerce, it is still subject to restraint by the United States Supreme Court. In *Best* v. *Maxwell*[32] the court unanimously disapproved a North Carolina statute which levied "an annual privilege tax of $250 on every person or corporation, not a regular retail merchant in the state, who displays samples in any hotel room rented or occupied temporarily for the purpose of securing retail orders." Through Mr. Justice Reed, the court calls attention to the fact that the statute is discriminatory, although nominally applying to "all who are not regular retail merchants in North Carolina, regardless of whether they are residents or non-residents"; for normally the competition would be by regular retail merchants residing in the state. The real competitors were subject to a tax of $1 per annum for the privilege of doing business.

In *Caskey Baking Co.* v. *Commonwealth of Virginia*,[33] a unanimous court, speaking through Mr. Justice Roberts, sustained a tax as not discriminatory. The State of Virginia imposed an annual license tax of $100 for each vehicle, upon every person, firm or corporation "who or which shall peddle goods, wares or merchandise by selling and delivering the same at the same time to licensed dealers or retailers at other than a definite place of business operated by the seller." The tax was not required of (1) a manufacturer taxable on capital by the state; (2) a distributor of manufactured

[29] 309 U. S. 33 (1940).

[30] 61 S. Ct. 866 (1941).

[31] 305 U. S. 434 (1939).

[32] 311 U. S. 454 (1940).

[33] 313 U. S. 117 (1941).

goods paying a state license tax on his purchases; or (3) wholesale dealers regularly licensed by the state and "who shall at the same time sell and deliver merchandise to retail merchants." The Caskey Baking Company, a West Virginia corporation which sold bread to grocers and other retailers in Virginia, and which came within none of the exempt classes, complained that the exemptions discriminated against interstate commerce. The court replied that the act was aimed at the purely local business of peddling, irrespective of the source of the goods sold, and that peddlers resident in Virginia who buy their goods within the state or procure them from extra-state sources, are alike subject to the act. To the contention that the wholesale peddlers were denied the equal protection of the law, it was replied that each of the excepted groups was subject to other taxes, and that the equal protection clause noes not prevent a state from classifying businesses for taxation or impose an iron rule of equality.

Nelson v. *Sears, Roebuck & Co.*[34] and its companion case, *Nelson* v. *Montgomery Ward & Company*,[35] now remain for consideration, which may properly be limited to the *Sears, Roebuck* case. Opinions in these cases were written by Mr. Justice Douglas. Mr. Justice Stone took no part in their consideration. Mr. Chief Justice Hughes joined in a dissent by Mr. Justice Roberts. The cases involve both the commerce and due process clauses.

The State of Iowa imposes an excise tax on all tangible personal property purchased "for use in this state" and provides that "every retailer maintaining a place of business in this state and making sales of tangible personal property for use in this state . . . shall at the time of making such sales, whether within or without the state, collect the tax imposed by this act from the purchaser." Sears, Roebuck & Co. is a New York corporation authorized to do business in Iowa and has various stores in that state. It paid without contest the tax on sales made at those stores, and also the tax on orders placed at those stores, even though shipment were made direct to the purchaser from one of its out-of-state branches. It "refused to collect the tax on mail orders sent by Iowa purchasers to its out-of-state branches and filled by direct shipments through the mails or a common carrier from those branches to the purchasers." The corporation contended that these transactions were interstate commerce; and also that the statute was discriminatory in that it did not require the collection of the tax by out-of-state mail-order houses which did not maintain a place of business in the state. Relying on *Wisconsin* v. *Penney Co.*,[36] the court said that "the purchaser is in

[34] 312 U. S. 359 (1941).

[35] 312 U. S. 373 (1941).

[36] 311 U. S. 435 (1940).

Iowa and the tax is upon use in Iowa"; that the mail orders are a part of the company's Iowa business, and that "sales made wholly in Iowa carry the same burden as these mail order sales."

With respect to the duty of the retailer maintaining a place of business in the state to collect the tax on mail orders, the court said that mail-order houses not maintaining a place of business in the state as foreign corporations "are not receiving benefits from Iowa for which it has the power to exact a price." But what would the court now hold if the state law should require that the tax be collected by all mail-order houses, whether they maintain a place of business in the state or not? The purchaser is still in Iowa; the use is still in Iowa; and the orders are still a part of the company's Iowa business. The court said in the *Sears, Roebuck* case: "The fact that under Iowa law the sale is made outside the state does not mean that the power of Iowa 'has nothing on which to operate'. *Wisconsin* v. *J. C. Penney Co.*, supra." The per curiam opinion in *Continental Assurance Company* v. *Tennessee*, to which reference has heretofore been made, appears to determine that transactions with another state by mail may still be local transactions. If a mail-order house which has a store in the state may be compelled to collect the tax on all mail-order sales, there is no reason why the same duty may not be imposed on a competitor which does not have such a store in the state.

The dissent of Mr. Justice Roberts in the *Sears, Roebuck* case is based upon the contention that the company's "mail order business is interstate commerce" and that the conduct of such business involves no local activity within the state. The majority view appears to be the more reasonable, after certain of its language has been ignored or distinguished.

In conclusion it may be repeated that the 1940-41 term of the United States Supreme Court was not an active one with respect to due process and commerce clause cases affecting state taxation. Rulings under the commerce clause were liberal with respect to state taxation, and were not detrimental to interstate commerce, though nothing was done to minimize the danger of multiple taxation of transactions in interstate commerce, for which *McGoldrick* v. *Berwind-White Coal Mining Co.*[37] opened the door. But when the danger presents itself, the court will probably meet it, even though it requires the use of the sophistry which the courts so strongly disapprove and so consistently use. Aside from the extension of multiple taxation of intangibles through the case of *Stewart* v. *Commonwealth of Pennsylvania*,[38] the cases dealing with due process of law are subject to little criticism, except as to their logic and their language.

[37] 309 U. S. 33 (1940).

[38] 312 U. S. 649 (1941).

CHAIRMAN GERSTENBERG: Thank you, Mr. Dodd.

The recent decisions in the field of federal income taxation will be given us by Mr. Randolph E. Paul of New York City, with whose very close reasoning in his three or four books most of you are acquainted.

Mr. Paul.

RECENT SUPREME COURT DECISIONS IN THE FIELD OF FEDERAL INCOME TAXATION

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The title of this paper has comprehensiveness even more ominous than the broad sweep of Section 22(a) of the Internal Revenue Code. Taking liberties with an ancient line, the power to give involves the power to take away, and the committee which supplied the title has protected the audience by limiting the speaker to twenty minutes. Even if the speaker should contravene recent policies of the Supreme Court and give a narrow and more than literal construction to the word "recent," he would have trouble unless he added limitations.

I shall add limitations by assuming that you are all familiar with the facts of recent Supreme Court life, and further that you will cheerfully do without a mere catalogue of holdings of the court. I shall also banish to footnotes — which you will not hear — some "recent" decisions that have relatively few implications for the majority of those who are interested in income taxation.[1] And, finally, I shall abstain from a repetition of stories ably told elsewhere by other commentators.[2]

It seems to me more valuable to attempt a synthesis of the trend of recent Supreme Court decisions. What do they mean in terms of the future? This is what should interest the practicing lawyer.[3]

[1] See, e.g., *Neuberger* v. *Comm.*, 311 U. S. 83 (1940), in which the court decided that individual losses of a partner may be offset against the partnership gains. See also *United States* v. *A. S. Kreider Co.*, 313 U. S. 443 (1941); *Helvering* v. *Oregon Mutual Life Insurance Co.*, 311 U. S. 267 (1940).

I wish I could discuss also the interesting procedural decisions in *Hormel* v. *Helvering*, 312 U. S. 552 (1941), and *Helvering* v. *Richter*, 312 U. S. 561 (1941), in which the court liberalized the rule as to the presentation of issues on appeal which were not presented below. But time will not allow such an excursion.

[2] Surrey, "The Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions", 35 *Ill. L. R.* 779 (1941; Magill, "The Supreme Court on Federal Taxation, 1939-40", 8 *U. of Chi. L. R.* 1 (1940); Nash, "What Law of Taxation?", 9 *Fordham L. R.* 165 (1940).

[3] Holmes, *Collected Legal Papers*, pp. 167, 169 (1920); Magill, "The Supreme Court on Federal Taxation, 1939-40", 8 *U. of Chi. L. R.* 1 (1940).

It is small comfort to a defeated litigant, as I have learned by personal experience,[4] to tell him that the Supreme Court had to overturn a long-standing, if unhonored, precedent [5] to defeat him; unreasonably, in the manner of clients, he thinks of his lawyer as one who should know well in advance when the Supreme Court will do such disturbing things. In his disappointment he may turn to another lawyer who has not yet marred his record for prophecy.

One need not apologize to the tax student for discussing the future of income tax law. If he is young, he wants to know the kind of judicial climate in which he will have to live his tax life, He wants a weather forecast. If he is older, he may still have kept his interest in, and his capacity for adjustment to, a changing tax order. It may even be changing as he wanted it to change, and as he worked to have it changed.

The special need for this type of approach is emphasized by the fact that in the Supreme Court, as well as elsewhere, a minority has become a majority. Indeed, able commentators have more forcefully said that the Supreme Court has "experienced a revolution." [6] All the Four Horsemen are gone.[7] Change "with its long arm, its disturbing touch, its decree of events not yet manifest—has come to all the folkways of appellate process. Legal issues have been stated in novel ways; concepts dominant have exchanged places with concepts recessive; a new relationship has been given to the question of substance and the legal mould in which it is cast." [8] The sacredness of the right to do "unsound" things is tottering; we now have a court which will indulge freedom to the things to come even if their shape does not accord with moulds already decreed by the court.[9]

CONSTITUTIONAL ISSUES

The heading of this section might well be "For Whom the Bell Tolls." When Mr. Justice McReynolds dramatically proclaimed in

[4] *Helvering* v. *Mountain Producers Corp.*, 303 U. S. 376 (1938). See also *New York ex rel. Cohn* v. *Graves*, 300 U. S. 308 (1937).

[5] *Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393 (1932).

[6] Hamilton and Braden, "The Special Competence of the Supreme Court", 50 *Yale L. J.* 1319 (1941).

[7] Meaning, of course, Van Devanter, McReynolds, Sutherland and Butler, JJ.

[8] Hamilton and Braden, "The Special Competence of the Supreme Court", 50 *Yale L. J.* 1319, 1320 (1941).

[9] For a cross-section of the literature of this revolution see the authorities noted in Hamilton and Braden, "The Special Competence of the Supreme Court", 50 *Yale L. J.* 1319, n. 1 (1941). See also Willkie, "The Court Is Now His", 212 *Saturday Evening Post*, No. 37, p. 29 (1940); Jackson, "A Square Deal for the Court", address delivered at Boston College Law School, Apr. 9, 1940.

the famous *Gold-clause* case that the constitution as he had known it was gone,[10] he could hardly have been thinking of the income tax. Just about twenty years ago Thomas Reed Powell apologized for a paper on constitutional aspects of the income tax because "the constitutional aspects of federal income taxation are relatively unimportant." And he sagely advised:[11] "Have recourse to the Constitution only when all other comforts fail."[12] Mr. Justice McReynolds, we may judge from agreement with many dissents,[13] would bitterly agree.

So far as the income tax is concerned, the last Supreme Court term added the few necessary finishing touches to the constitution as Mr. Justice McReynolds had known it. The Court has adopted the approach of Mr. Justice Cardozo[14] that constitutional issues must be dealt with in a large way, and not pedantically. But language of apology is missing; new approaches are being taken for granted.[15] It is a definite step forward when opinions on constitutional issues are short and almost snappy.

The *Bruun* case[16] furnishes a striking example of how little is left of the unreconstituted constitution. The few pages of the opinion in that case, written by Mr. Justice Roberts, courteously distinguish *Eisner* v. *Macomber*[17] out of existence. No longer will

[10] *Norman* v. *Baltimore & Ohio R. R. Co.*, 294 U. S. 240 (1935).

[11] Powell, "Constitutional Aspects of the Federal Income Tax", contained in *The Federal Income Tax*, p. 51 (1921).

[12] Professor Powell summarized his paper (at p. 90) by telling the story of the distinguished psychologist whose friend told him how much he enjoyed his lecture. "'But you weren't there,' was the surprised response. 'No,' was the rejoinder, 'but Jones gave me an excellent summary of it. He told me that you spoke on imageless thought and said that there wasn't any.'"

[13] See, e.g., *Burnet* v. *Wells*, 289 U. S. 670 (1933); *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85 (1935). See also *Heiner* v. *Donnan*, 285 U. S. 312 (1932), rehearing 61 F (2d) 113 (CCA 3d, 1932); *Nichols* v. *Coolidge*, 274 U. S. 531 (1927); *Hoeper* v. *Tax Commission of Wisconsin*, 284 U. S. 206 (1931); *Schlesinger* v. *Wisconsin*, 270 U. S. 230 (1926). *Cf. Helvering* v. *Midland Mutual Life Insurance Co.*, 300 U. S. 216 (1937); *Helvering* v. *Horst*, 311 U. S. 112 (1940); *Helvering* v. *Clifford*, 309 U. S. 331 (1940); *Helvering* v. *Eubank*, 311 U. S. 122 (1940). Mr. Justice McReynolds may certainly be credited with a liberal constitutional attitude for his opinion in *Taft* v. *Bowers*, 278 U. S. 470 (1929).

[14] See *Burnet* v. *Wells*, 289 U. S. 670 (1933).

[15] See *Helvering* v. *Northwest Steel Rolling Mills, Inc.*, 311 U. S. 46, 52 (1940), to the effect that a corporation's charter, taken together with state law, does not constitute "an executed written contract expressly dealing with the payment of dividends." See 1936 Act, Sec. 26(c)(1).

[16] *Helvering* v. *Bruun*, 309 U. S. 461 (1940).

[17] 252 U. S. 189 (1920).

the concept of income be restricted to the paralyzing requirement that it must be something proceeding from and severed from capital for the separate use, benefit and disposal of the taxpayer. Something else may now answer the description. Importance is all along the line, but in the stock dividend area new test cases are now being advanced so that common stock dividends upon common stock, with no other class of stock outstanding, may soon be taxable income.[18]

Mr. Stanley Surrey, Assistant Legislative Counsel of the Treasury, has said, no doubt in the mood of hyperbole, that the constitution is "an historic relic" and can now "scarcely claim a place even in the attic of the Supreme Court."[19] One need not be quite so dramatic in sorrow. Mr. Surrey was probably speaking of Mr. Justice McReynolds's concept of the constitution, which is, indeed, a lost symbol. Other critics have called the "extreme economic philosophy" of the "New Deal majority in the Court" a "trend toward confiscation of private property . . . in violation of the letter and spirit of the Constitution."[20] Of course, such statements are gross exaggerations. Constitutional victories for taxpayers in the income tax field have always been noted for their rarity;[21] the sixteenth amendment has been the principal impediment to the development of a sound income tax system. In the estate tax field the versatile fifth amendment[22] has a quota of damage to its discredit; moreover, in both branches of taxation fears of unconstitutionality have frequently distorted the interpretative process.[23]

Speaking more broadly, in the earlier days of modern taxation constitutional issues were overmagnified and some reaction was inevitable. The constitution was badly construed, and the court is now putting constitutional restraints at a much more remote point. It is easy at such a time to lose perspective and to think that all restraints are gone. I should revise Mr. Surrey's previously quoted summary by saying that some of the gloss of the constitution—some of the judge-made law of the constitution nowhere found in the text

[18] See, e.g., *Frank M. Travis*, B.T.A. Docket No. 105950.

[19] Surrey, "The Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions", 35 *Ill. L. R.* 779, 792-3 (1941).

[20] Lawrence, "High Court Captured in Tax Cases", *The Evening Star,* (Washington, D. C., Oct. 9, 1940). See also Mr. Lawrence's discussion in the *New York Sun*, July 14, 1941).

[21] *Eisner* v. *Macomber,* 252 U. S. 189 (1920); *Edwards* v. *Cuba R. R. Co.*, 268 U. S. 628 (1925); *Evans* v. *Gore,* 253 U. S. 245 (1920); overruled by *O'Malley* v. *Woodrough,* 307 U. S. 277 (1939).

[22] Frankfurter, *Law and Politics*, p. 54 (1939).

[23] See, e.g., *Lucas* v. *Alexander,* 279 U. S. 573, 577 (1929); *Lewellyn* v. *Frick,* 268 U. S. 238 (1925); *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339 (1929).

of the instrument—is going to the attic. To change the metaphor, the reconstituted Supreme Court is chloroforming some of the old rabbits which their predecessors had pulled out of the constitutional hat. We have a reinterpreted constitution, not no constitution at all. We shall surely preserve a constitution to implement the promise that the power to tax shall not be the power to destroy while the Supreme Court sits.[24]

STATUTORY CONSTRUCTION

Since our tax statute is anchored in statutory law,[25] the principal tax labors of the Supreme Court are in the vineyards of statutory construction. Here we may note in recent income tax cases a new tendency that is hard to define. Some will categorically denounce it as an overprotection of revenue. But in several cases [26] illustrative of the new tendency the court has hardly strained to protect the revenue. This description, therefore, fails.

Increasingly noticeable in recent Supreme Court decisions is a refusal to be bound by the literal language of statutes.[27] The old naïve criterion of "plain and unambiguous" meaning of the words of the statute [28] has gone with Mr. Justice McReynolds's concept

[24] Holmes, J., dissenting in *Panhandle Oil Co.* v. *Knox*, 277 U. S. 218, 223 (1928); Frankfurter, J., concurring in *Graves* v. *New York ex rel. O'Keefe*, 306 U. S. 466, 491-2 (1939).

[25] Surrey, "The Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions", 35 *Ill. L. R.* 779, 804 (1941).

[26] *Helvering* v. *Janney*, 311 U. S. 189 (1940), in which the Court decided to the effect that the losses of one spouse may be deducted from the capital gains of the other when a joint return is filed; *Taft* v. *Helvering*, 311 U. S. 195 (1940), dealing similarly with the cognate question of charitable contributions. See also *Neuberger* v. *Comm.*, 311 U. S. 83 (1940); *Helvering* v. *Wood*, 309 U. S. 344 (1940); *Maass* v. *Higgins*, 312 U. S. 443 (1941).

[27] *LeTulle* v. *Scofield*, 308 U. S. 415 (1940); *Gregory* v. *Helvering*, 293 U. S. 465 (1935); *cf. Crooks* v. *Harrelson*, 282 U. S. 55, 59 (1930). *Cf.* also *Helvering* v. *Hammel*, 311 U. S. 504 (1941), where the court refused to adopt a literal or usual meaning of the words of the statute where absurd consequences or a thwarting of the obvious purpose do not result from the literal or usual meaning. In this case the court held that the loss of a mortgagor upon foreclosure is a capital loss deductible only to the limited extent permitted by Sections 23(j) and 117(d) of the 1934 Act, and not in full under Section 23(e)(2). *Cf. Hort* v. *Comm.*, 313 U. S. 28 (1941), in which the court held that an amount received by a lessor in consideration of the cancellation of a lease was ordinary income; *Helvering* v. *Flaccus Oak Leather Co.*, 313 U. S. 247 (1941), in which the court held that the gain involved in fire insurance proceeds was not a capital gain.

[28] Jones, "Statutory Doubts and Legislative Intention", 40 *Col. L. R.* 957 (1940); Jones, "The Plain Meaning Rule", 25 *Wash. U. L. Q.* 1 (1939). The majority technique in *Caminetti* v. *United States*, 242 U. S. 470 (1917), the famous *White Slave Traffic* case, is a good example of the application of this criterion. Compare the dissent of Mr. Justice McKenna.

of the constitution. "When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination.'"[29] In place of the old criterion we thus have a new recognition of the truth that words are hardly ever plain,[30] especially in a tax statute. The first resort is, of course, to the statutory language. "While one may not end with the words of a disputed statute, one certainly begins there."[31] But one must look beyond words to intent[32] and policy.[33] The new court is following the old tradition of interpretation that statutory provisions should be construed to give effect to the purpose of the legislature, however difficult of ascertainment of that purpose may be when the legislature consists of 435 members of the House and 96 Senators.[34] The corollary is that when words have been ineptly chosen, it is the duty of the court to endow them with appropriate

[29] *United States* v. *American Trucking Associations, Inc.*, 310 U. S. 534, 543-4 (1940). See also *United States* v. *Dickerson*, 310 U. S. 554, 561-2 (1940).

[30] Green, "The Duty Problem in Negligence Cases," 28 *Col. L. R.* 1014 (1928); Ogden and Richards, *The Meaning of Meaning*, p. 109 *et seq.* (1927); Frank, *Law and the Modern Mind*, p. 57 *et seq.* (1930); Chase, *The Tyranny of Words*, pp. 167, 291, 326 (1938).

[31] *Federal Trade Commission* v. *Bunte Bros., Inc.*, 312 U. S. 349, 350 (1941). See *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 464 (1934).

[32] For an interesting debate between Professor Radin and Dean Landis, see Radin, "Statutory Interpretation," 43 *Harv. L. R.* 863 (1930), and Landis, "A Note on Statutory Interpretation," 43 *Harv. L. R.* 886 (1930). Radin asserts (at p. 881) that the "'intent of the legislature'" is a "futile bit of fiction." Landis says (at p. 893): ". . . the emphasis must lie upon the honest effort of courts to give effect to the legislature's aims, even though their perception be perforce through a glass darkly. There will and must remain that group of cases—smaller than is generally supposed—where no meaning, aim, or purpose of the legislature is at all capable of apperception. Here and here alone does talk of the intent of the legislature become meaningless and barbaric. And here society and the legislature both entrust themselves to the law-making powers of courts. No science of law has yet done away with the need for such occasional legislation; a science of statutory interpretation can hardly hope to fare better. But the insistence of both must be that judicial legislation shall concern itself only with the interstitial tissues of the body politic and not its gristle." See also de Sloovère, "Extrinsic Aids in the Interpretation of Statutes," 88 *U. of Pa. L. R.* 527, 538 (1940); Horack, "In the Name of Legislative Intention," 38 *W. Va. L. Q.* 119 (1932).

[33] Holmes, *The Common Law*, p. 78 (1881); Powell, "Some Aspects of American Constitutional Law," 53 *Harv. L. R.* 529 (1940). See the reference to "policy" and "mere letter" of the law in *Bullen* v. *Wisconsin*, 240 U. S. 625 (1916).

[34] Radin, "Statutory Interpretation," 43 *Harv. L. R.* 863, 870 (1930); Jones, "Statutory Doubts and Legislative Intention," 40 *Col. L. R.* 957, 967 (1940).

meaning.[35] Words may have "many meanings, depending on the context." [36]

Conventional rules of construction perish by the wayside of the direct route to the meaning Congress is thought to have had. The rule that the Congressional reenactment of statutory language gives sanction to a previous administrative construction is "no more than an aid in statutory construction. While it is useful at times in resolving statutory ambiguities, it does not mean that the prior construction has become so embedded in the law that only Congress can effect a change." [37] A high standard of uniformity and continuity will be required of an administrative construction.[38] The maxim *expressio unius est exclusio alterius* has suffered hardly a better fate; as an aid to construction it "can never override clear and contrary evidences of Congressional intent." [39] But rules of statutory construction—such as the rule that the title of an act may help to resolve an ambiguity—may be called to the aid of the court in a case in which the court refuses to construe a statute in such a way as to create an "opportunity for manipulation of tax liability" or to "open an avenue for tax avoidance." [40]

So much for the new adoption of an old technique of statutory construction. The readoption of this technique is profoundly significant. It is a move away from transcendentalism.[41] Tax law may be said to be growing rapidly in the direction of a recognition of

[35] Hamilton and Braden, "The Special Competence of the Supreme Court," 50 *Yale L. J.* 1319, 1362 (1941).

[36] *Helvering* v. *Hammel*, 311 U. S. 504, 507 (1941). See Holmes, "The Theory of Legal Interpretation," 12 *Harv. L. R.* 417 (1899). See also *Towne* v. *Eisner*, 245 U. S. 418 (1918).

[37] *Helvering* v. *Reynolds*, 313 U. S. 428, 432 (1941), holding that the basis of property acquired by the taxpayer under a contingent remainder interest in a testamentary trust is the value of the property at the date of death of the testator. See *Federal Communications Commission* v. *Columbia Broadcasting System*, 311 U. S. 132, 137 (1940). *Cf. Helvering* v. *Janney*, 311 U. S. 189 (1940).

[38] *Higgins* v. *Comm.*, 312 U. S. 212 (1941), denying the taxpayer a deduction for office expenses on the ground that overseeing investments is not doing business; *cf. United States* v. *Pyne*, 313 U. S. 127 (1941); *City Bank Farmers Trust Co.* v. *Helvering*, 313 U. S. 121 (1941). See also *Estate of Sanford* v. *Comm.*, 308 U. S. 39 (1939); *Maguire* v. *Comm.*, 313 U. S. 1, 8 (1941).

[39] *Neuberger* v. *Comm.*, 311 U. S. 83, 88 (1940). See Radin, "Statutory Interpretation," 43 *Harv. L. R.* 863, 873, 885 (1930).

[40] *Maguire* v. *Comm.*, 313 U. S. 1, 8, 10 (1941); *Helvering* v. *Gambrill*, 313 U. S. 11 (1941); *Helvering* v. *Campbell*, 313 U. S. 15 (1941).

[41] Cohen, "Transcendental Nonsense and the Functional Approach," 35 *Col. L. R.* 809 (1935).

what may be called, for lack of a better term, "economic realities."[42] The court is paying less and less attention to gossamer refinements of title; [43] and elusive and subtle casuistries of the law of property,[44] technical distinctions,[45] and attenuated subtleties,[46] are of little remaining avail. Nor may fictions be utilized to accomplish escape from the tax.[47] The court has erased "fine distinctions," demolished "esoteric dialectic," torn away "corporate veils," and swept into the discard "an ingenious mosaic of theology." [48] In short, the courts are learning to think of the income tax in terms of "things and results." [49] For the future, we may expect that the courts will be less distracted "from the actual — or potentially actual—world into a fictitious word-world, or, rather, a fake word-heaven where dwell bogus verbal entities, all words and no substance." [50]

The generic result is plain enough. It is a rapidly expending concept of income,[51] a more flexible concept designed to encompass the variety of circumstances that produce income in an extremely complicated modern world, and which takes sufficient note of the attempts of taxpayers at circumvention of the revenue.[52] We have

[42] *Cf. Higgins* v. *Smith*, 308 U. S. 473 (1940). Of course, the word "realities" is a word of many colors. "The issue is of the type, not unfamiliar in the law, where the distinctions are not black and white, but of varying shades of gray and where the shade chosen by a court will seem 'realistic' to him whose side wins and artificial or fanciful to the other." *Comm.* v. *Dravo*, 119 F (2d) 97, 99 (CCA 3d, 1941).

[43] *Griffiths* v. *Comm.*, 308 U. S. 355, 357 (1939); *Corliss* v. *Bowers*, 281 U. S. 376, 378 (1930).

[44] *Helvering* v. *Hallock*, 309 U. S. 106, 118 (1940), rehearing pursuant to mandate 111 F (2d) 143 (CCA 6th, 1940); *United States* v. *Jacobs*, 306 U. S. 363, 369 (1939).

[45] *Chase National Bank* v. *United States*, 278 U. S. 327, 336 (1929).

[46] *Lucas* v. *Earl*, 281 U. S. 111, 114 (1930).

[47] *United States* v. *Jacobs*, 306 U. S. 363, 369 (1939); *cf.* Roberts, J., dissenting in *Higgins* v. *Smith*, 308 U. S. 473 (1940). Nor may fictions account for a refusal to give justice to taxpayers. *Hammond-Knowlton* v. *United States*, 121 F (2d) 192 (CCA 2d, 1941).

[48] Hamilton and Braden, "The Supreme Court Today," 103 *New Republic* 178, 179 (1940).

[49] Holmes, *Collected Legal Papers*, p. 282 (1920).

[50] Frank, "A Lawyer Looks at Language," published in the appendix of Hayakawa, *Language in Action* (1941).

[51] *Helvering* v. *Clifford*, 309 U. S. 331 (1940); *Helvering* v. *Horst*, 311 U. S. 112 (1940). Space does not permit a discussion of the administrative aftermath of the Clifford case, but it may be said briefly that in *Hormel* v. *Helvering*, 312 U. S. 552 (1941), the court clarified the rule with respect to the consideration on appeal of points not raised below.

[52] *Higgins* v. *Smith*, 308 U. S. 473 (1940). See Paul, "The Background of the Revenue Act of 1937," 5 *U. of Chi. L. R.* 41 (1937).

journeyed a long distance from the sophistications of *Eisner* v. *Macomber* to the realities of *Helvering* v. *Bruun,* which Surrey well says "marks the end of one era in our tax history." [53] *Helvering* v. *Enright* [54] is a milestone in its recognition that Section 42 permits the inclusion, as accruable items, of a decedent's gross income for the period ending with his death, of his share of the profits earned, but not yet received, of a partnership, when both the decedent and the partnership reported income on a cash basis. We are far along on another journey begun a few years ago in *Burnet* v. *Wells,*[55] which introduced the concept of a family solidarity so generously developed in the *Clifford* case. In the *Horst* case the ghost of Veblen stepped into our modern income tax picture, and vicarious nonmaterial satisfaction became a type of income realization.[56] The problem of determining the taxpayer was developed in *Harrison* v. *Schaffner,*[57] perhaps at the expense of a precedent much honored by tax avoiders.[58]

In the web of this new trend has been an increased concern with actual command and dominion over property and an emphasis upon the benefit [59] derived therefrom. Taxation is "not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid." [60] It makes no difference that such "command" may be exercised through specific retention of legal title or the creation of a new equitable but controlled interest, or the maintenance of effective benefit through the interposition of a subservient agency.[61] Progressively the courts have endeavored to bring about a "correspondence between the legal concept of ownership and the eco-

[53] Surrey, "The Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions," 35 *Ill. L. R.* 779, 783 (1941).

[54] 312 U. S. 636 (1941); *Pfaff* v. *Comm.,* 312 U. S. 646 (1941).

[55] 289 U. S. 670 (1933).

[56] *Comm.* v. *Buck,* 120 F (2d) 775 (CCA 2d, 1941).

[57] 313 U. S. 579 (1941).

[58] It is an unsettled question what remains of the *Blair* case, 300 U. S. 5 (1937). One member of the Court of Appeals of the District of Columbia has said that nothing remains. See *Huber* v. *Helvering,* 117 F (2d) 782 (App. D. C., 1941). But Judge Groner's remark was made before the Supreme Court decided *Harrison* v. *Schaffner,* which makes it plain that the *Blair* case still rules where there is an outright assignment of a life or similar interest.

[59] *Higgins* v. *Smith,* 308 U. S. 473 (1940).

[60] *Corliss* v. *Bowers,* 281 U. S. 376, 378 (1930); *Burnet* v. *Guggenheim,* 288 U. S. 280, 283 (1933).

[61] *Griffith* v. *Comm.,* 308 U. S. 355, 358 (1939).

nomic realities of enjoyment or fruition."[62] "The power to dispose of income is the equivalent of ownership of it."[63] One who is vested with the right to receive income does not escape the tax "by any kind of anticipatory arrangement, however skillfully devised, by which he procures payment of it to another, since, by the exercise of his power to command the income, he enjoys the benefit of the income on which the tax is laid."[64] The new concept of ownership is well summarized by Judge Frank in the *Buck* case where he says:[65]

> ". . . 'ownership' is not a term of inflexible meaning, and . . . what is relevant to 'ownership' in determining the niceties of rights or duties under the rules concerning trust estates may need to be disregarded in applying the cruder test of taxability; in the law of trusts the cutting edge of the pertinent rule must be razor-sharp, while in income tax law, involving so sweeping a provision as Section 22(a), the helpful image is rather that of a broad-sword."

In the field of exemptions and deductions recent Supreme Court opinions show a contrary tendency.[66] Here we may note what defeated litigants must regard as an inordinate respect for the literal language of the statute and the time-honored rule that exemption provisions must be strictly construed.[67] Relief from hardship is a favor of the legislature, not the courts. The court "must apply the statute as we find it, leaving to Congress the correction of asserted inconsistencies and inequalities in its operation."[68] One may argue that this is an inconsistent attitude, though one must remember that it is one thing to insure the revenue and quite another thing to invade the province of legislative grace. On the other hand, there is danger of a one-sided application of the doctrine of free interpretation. The process of interpretation of tax statutes should be kept a two-way street.

[62] *Burnet* v. *Wells*, 289 U. S. 670, 677 (1933). See Rudick, "The Problem of Personal Income Tax Avoidance," 7 *Law & Contemp. Prob.* 243 (940).

[63] *Helvering* v. *Horst*, 311 U. S. 112, 118 (1940).

[64] *Harrison* v. *Schaffner*, 312 U. S. 579, 582 (1941).

[65] *Comm.* v. *Buck*, 120 F (2d) 775, 777 (CCA 2d, 1941).

[66] See, however, *Helvering* v. *Hutchings*, 312 U. S. 393 (1941), to the effect that a donor is entitled to an "exclusion" for each beneficiary of a trust.

[67] *United States* v. *Stewart*, 311 U. S. 60 (1940); *Helvering* v. *Northwest Steel Rolling Mills, Inc.*, 311 U. S. 46 (1940); *Riley Investment Co.* v. *Comm.*, 311 U. S. 55 (1940). For a less recent case see *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 464 (1934).

[68] *McClain* v. *Comm.*, 311 U. S. 527, 530 (1941), to the effect that a loss on the retirement of bonds is a capital loss.

JUDICIAL LEGISLATION

The next aspect of the latest tendency in statutory construction, if we may call it that, is a tender subject. Even within the court, protest is highly articulate.[69] Outside the court there is plenty of dissent. In some quarters of the tax world there is consternation. One commentator has entitled an able and provocative article "What Law of Taxation?"[70] In all tax gatherings one constantly hears the question, "How may we advise our clients any more?"

I will let the cat out of the bag and admit that I am talking about "judicial legislation." In the last reported case in Volume 257 of the U. S. Reports, *Smietanka* v. *First Trust & Savings Bank*,[71] decided just less than twenty years ago, the court said:

> ". . . It may be that Congress had a general intention to tax all incomes whether for the benefit of persons living or unborn, but a general intention of this kind must be carried into language which can be reasonably construed to effect it. Otherwise the intention can not be enforced by the courts. The provisions of such acts are not to be extended by implication. . . ."

Speaking of a ruling of the commissioner, the court added: "This seems to us to graft something on the statute that is not there. It is an amendment and not a construction, and such an amendment was made in subsequent income tax laws as we shall see." Finally the court said: "It is obvious that, in the acts subsequent to that of 1913, Congress sought to make specific provision for the *casus omissus* in the earlier act."[72]

Can anyone imagine such words from the court that decided *Helvering* v. *Clifford* and *Higgins* v. *Smith*?[73]

Before thinking of the problem of judicial legislation in terms of recent cases and in the light of the current income tax situation, one should pause to remember that there is nothing new in the complaints we hear today against judicial legislation. Francis Bacon

[69] See Roberts, J., dissenting in *Helvering* v. *Clifford*, 309 U. S. 331, 338 (1940), in *Higgins* v. *Smith*, 308 U. S. 473, 480 (1940), in *Helvering* v. *Hallock*, 309 U. S. 106, 123 (1940), rehearing pursuant to mandate 111 F (2d) 143 (CCA 6th, 1940), and in *United States* v. *Hutcheson*, 312 U. S. 219, 245 (1941).

[70] Nash, "What Law of Taxation?", 9 *Fordham L. R.* 165 (1940).

[71] 257 U. S. 602, 605-6 (1922). See also *Iselin* v. *United States*, 270 U. S. 245, 251 (1926). But see Holmes, J., thirty-three years ago in *Johnson* v. *United States*, 163 Fed. 30 (CCA 1st, 1908), later decision 170 Fed. 581 (CCA 1st, 1909).

[72] 257 U. S. at p. 607.

[73] Yet in *Maass* v. *Higgins*, 312 U. S. 443, 448-9 (1941), Mr. Justice Roberts, writing for the majority, said: "If Congress intended the result for which the Government contends, . . . it would have been a simple matter so to state."

said that the office of judges was to interpret, not to make or give law.[74] For a comparatively recent example, as long ago as 1895 Mr. Justice White, later Chief Justice, spoke of a "judicial amendment of the Constitution."[75] In 1907 judicial legislation was called the one cardinal sin of which jurists must beware.[76] In *Standard Oil Company* v. *United States*[77] Mr. Justice Harlan vigorously protested against the "judicial legislation" involved in applying the rule of reason to the Sherman Act.

The process of interpretation used to be called "discovering" law which already existed. Judge Frank calls it the "Columbus" theory.[78] From the standpoint of judicial legislation relating to statutes, we have two types: (1) the type which narrows the meaning of the statute, and (2) the type which is generous with legislation. The former type has an ancient history. The Year Books and Coke and our Nineteenth Century reports are full of examples. The Four Horsemen were past masters of the art. The process consisted of narrowing the meaning of statutes, and sometimes virtually nullifying them, because the courts disliked what the legislature intended. Mr. Justice Holmes advocated the more generous type of attitude, even where he did not agree with the legislation under consideration.[79] So did Mr. Justice Cardozo.[80] So does Chief Justice Stone.[81] These and more recently appointed justices are perhaps more candidly admitting their attitude, but apart from disclosure they are following old leads.

[74] Levy, *Cardozo and Frontiers of Legal Thinking*, p. 39 (1938).

[75] *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 639 (1895), rehearing 158 U. S. 601 (1895), discussed in Jackson, *Struggle for Judicial Supremacy*, p. 47 (1941). See also Corwin, *Court over Constitution*, c. 4 (1938).

[76] Sharswood, "Essay on Professional Ethics," 3 *A.B.A. Report* 45 (1907). But Dicey, in 1905, said that "nine-tenths, at least, of the law of contracts and the whole, or nearly the whole, of the law of torts are not to be discovered in any volume of the statutes." *Law and Opinion in England*, p. 362 (1905), quoted by Frank, *Law and the Modern Mind*, p. 33 (1930). And Gray said the same in *The Nature and the Sources of Law*, p. 96 *et seq.* (2d Ed., 1921), and Cardozo in 1921, in *The Nature of the Judicial Process*, p. 10 (1921).

[77] 221 U. S. 1, 100, 103, 105 (1911). See *Apex Hosiery Co.* v. *Leader*, 310 U. S. 469, 489, 499 (1940). For an early case where Story in circuit overrode literal language see *Harden* v. *Gordon*, Fed. Cas. No. 61047 (1823).

[78] See Frank, *Law and the Modern Mind*, p. 32 (1930); 5 Holdsworth, *History of the English Law*, p. 473 (1937), as to lawyers' false stress on continuity of doctrines; Pound, "Spurious Interpretation" 7 *Col. L. R.* 379, 381 (1907).

[79] See, e.g., *Johnson* v. *United States*, 163 Fed. 30 (CCA 1st, 1908), later decision 170 Fed. 581 (CCA 1st, 1909).

[80] Cardozo, *The Nature of the Judicial Process*, p. 10 (1921).

[81] Stone, "The Common Law in the United States," 50 *Harv. L. R.* 4 (1936).

The same distinction between narrow and generous interpretation is apparent in connection with constitutional interpretation. After all, the constitution is a special kind of legislation, a code of peculiar importance; its interpretation is not essentially different from statutory interpretation. Chief Justice Marshall, however much he may have used the language of the "Columbus" theory in *Osborn* v. *United States Bank*,[82] sustained in that case the constitutional power of Congress to create a bank of the United States; in doing so he went the limit in a liberal interpretation of the Constitution, which does not have a word expressly referring to any power to create a bank. Looking at the problem from the standpoint of judicial legislation not relating to statutes, most of our common law is judge-made.[83] Chief Justice Stone has said[84] that the history of law in the United States would be largely "an account of the means by which the common-law system has been able to make progress through a period of exceptionally rapid social and economic change." What was the law in the time of Richard Coeur de Lion on the liability of a telegraph company to the person to whom a message was sent?[85]

Much recent protest against judicial legislation is, at the core, nothing more than a complaint that the court sees some specific meaning in a statute that Congress did not see at the time of enactment. But this is a valid process. Congress enacts in wholesale, the courts must interpret in retail. It is impossible to anticipate when a statute is enacted the many specific situations to which it may have to be applied.[86] Statutes must be expressed in general and more or less abstract terms.[87] The job of the courts is often to see what would have been in the mind of the legislature if the precise point involved in the case before the court had occurred to the legislature when it was framing the statute.[88]

Moreover, complaints against judicial legislation are often nothing more than puzzlement at a new decision, the implications of which

[82] 9 Wheat. 738 (U. S., 1924).

[83] See Frank, *Law and the Modern Mind*, pp. 33, 328 (1930).

[84] Stone, "The Common Law in the United States," 50 *Harv. L. R.* 4, 11 (1936).

[85] Gray, *The Nature and Sources of Law*, p. 99 (2d Ed., 1921).

[86] *Cf. Gorieb* v. *Fox*, 274 U. S. 603, 607 (1927); *Steward Machine Co.* v. *Davis*, 301 U. S. 548, 591 (1937).

[87] Gray, *The Nature and Sources of the Law*, p. 161 (2d Ed., 1921); Cohen, *Law and the Social Order*, p. 133 (1933).

[88] Cardozo, *The Nature of the Judicial Process*, pp. 14-5 (1921); Frank, *Law and the Modern Mind*, pp. 189-91 (1930); Jones, "Statutory Doubts and Legislative Intention," 40 *Col. L. R.* 957, 973 (1940); Jones, "The Plain Meaning Rule," 25 *Wash. U. L. Q.* 1, 3 (1939); cf. Aristotle, *Ethics*, bks. 5, 14, quoted in Frank, *Law and the Modern Mind*, p. 139 (1930).

are bound in the beginning to be uncertain. The process of inclusion and exclusion, "so often applied in developing a rule, cannot end with its first enunciation."[89] Our system of law has been described as "developed by a gradual pricking out point by point by one decision after another of a rule or principle, indistinct at first, but assuming definite shape by slow degrees."[90] These principles are forcibly illustrated by the *Clifford* decision. The immediate result of the decision is a wake of confusion.[91] *Helvering* v. *Fuller*[92] casts hints which Government attorneys will not ignore. It is safe to predict that *Helvering* v. *Horst* will be dogged by a similar fate.[93] Perhaps the greatest element of strength from the viewpoint of tax avoidance in such decisions as the *Clifford* and *Horst* cases is their vary vagueness.[94]

Much of the complaint we hear today is nostalgic yearning for a certainly and repose we once thought we had because we had learned the rules that are passing away. We were well stored with the old rules, and now we are no better than any other man who is without them. Our capitalistic edifice of tax knowledge is crumbling and we shudder at the thought of rebuilding.[95] Criticism of judicial usurpation of the legislative function should rise to greater dignity. Mr. Surrey has discussed the subject on an appropriate level in a recent law review article.[96] He points out that criticism should take into account the uneven composition of our revenue laws. Some of the most important provisions are no more than the vaguest of generalities.[97] There are startling contrasts in other provisions in which every word has been carefully weighed and must be given its part to play.[98] This extreme diversity in statutory formation

[89] Brandeis, J., dissenting in *Washington* v. *Dawson & Co.*, 264 U. S. 219, 236 (1924). *Cf.* Black, J., concurring in *Helvering* v. *Gerhardt*, 304 U. S. 405, 425 (1938).

[90] Williston, *Some Modern Tendencies in the Law*, p. 5 (1929).

[91] Paul, *Studies in Federal Taxation, Third Series*, p. 204 (1940). See Griswold, "A Summary of the Regulations Problem," 54 *Harv. L. R.* 398, 421-2 (1941); *cf.* Ray, "The Income Tax on Short Term and Revocable Trusts," 53 *Harv. L. R.* 1322, 1352 (1940).

[92] 310 U. S. 69 (1940).

[93] See *Huber* v. *Helvering*, 117 F (2d) 782 (App. D. C., 1941).

[94] Pavenstedt, "The Broadened Scope of Section 22(a): The Evolution of the *Clifford* Doctrine," 51 *Yale L. J.* — (1941).

[95] Paul, *Studies in Federal Taxation*, Third Series, p. 208 (1940). *Cf.* *Hammond-Knowlton* v. *United States*, 121 F (2d) 192 (CCA 2d, 1941), as to "the vested interests of a few lawyers in their acquired knowledge of a foundation that no longer has any reasonable excuse for existence."

[96] See Surrey, "The Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions," 35 *Ill. L. R.* 779, 805 (1941).

[97] See, for example, Section 23 (a), (e) and (k) of the Internal Revenue Code.

[98] See, for example, Sections 112 and 113 of the Code.

makes for extreme difficulty in the application of the statute to the hard cases which reach the courts. The next complicating factor is induced by the annual progression of our statutes. This difficulty is illustrated by *Higgins* v. *Smith* [99] in which the court had to deal with the difficulty caused by the adoption of a new statutory provision because of dissatisfaction, confusion and uncertainty with respect of the application of a provision already in the statute, the problem being whether this alteration should be given any weight in the interpretation of the earlier law. Still another difficulty is Congressional apathy. Certainly Congress has not always been diligent in dealing with troublesome situations which have been called to its attention.

Something must be done about tax avoidance.[100] "Legislative ingenuity need not be the sole response to taxpayer ingenuity."[101] But an unfair burden may be placed upon the courts by Congressional inaction, and paradoxically the recent decisions of the Supreme Court place a responsibility upon Congress that is greater than at any time in our income tax history. An even greater responsibility lies at the door of the Treasury. Congress has been challenged by the present approach in income tax cases to adopt an aggressive attitude in the tax field and to construct a sound tax policy.[102] This challenge has been intensified by recent and contemplated rate increases which intensify every defect of the statute.[103]

In the last analysis the problem of judicial legislation is one of degree. We may not all agree that some judicial legislation is necessary to enable the adaptation of statutes to changing climates of opinion and new conditions.[104] But whether we like it or not, we may as well, as did Mr. Justice Cardozo, accept judge-made law as one of the realities of life.[105] Almost everyone will agree with

[99] 308 U. S. 473 (1940).

[100] See Paul, "The Background of the Revenue Act of 1937," 5 *U. of Chi. L. R.* 41 (1937).

[101] See *Maguire* v. *Comm.*, 313 U. S. 1, 8, 10 (1941).

[102] Surrey, "The Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions," 35 *Ill. L. R.* 779, 810, 813, 814, 815 (1941).

[103] Paul, "Redesigning Federal Taxation" 19 *Harv. Bus. Rev.* 143 (1941).

[104] See Cohen, *Law and the Social Order*, p. 112 (1933).

[105] Cardozo, *The Nature of the Judicial Process*, p. 10 (1921); Frank, *Law and the Modern Mind*, c. 4 and also p. 328 (1930). See Bingham, "What Is the Law?", 11 *Mich. L. R.* 109, 120 (1912). See also J. Smith, "Surviving Fictions," 27 *Yale L. J.* 147 (1917); de Sloovère, "The Equity and Reason of a Statute," 21 *Corn. L. Q.* 591, 602 (1936); Simpson, "Fifty Years of American Equity," 50 *Harv. L. R.* 171, 233 (1936); Paul, *Studies in Federal Taxation*, p. 133 (1937).

Mr. Justice Holmes's statement that it should be interstitial,—"from molar to molecular motions." [106] Mr. Justice Roberts, dissenting in the *Clifford* case, objected to writing into the statute "what is not there and what Congress has omitted to place there." In *Helvering* v. *Wood* Mr. Justice Dougles, writing for the majority, said that "We have only the responsibility of carrying out the congressional mandate. And where Congress has drawn a distinction, however nice, it is not proper for us to obliterate it." [107] Mr. Justice Douglas wrote the opinion in the *Clifford* case to which Mr. Justice Roberts objected.[108] Certainly judicial legislation is not a crystal-clear concept.

If it is true that the pendulum has swung in the direction of greater freedom for judicial legislation, responsibilities have certainly been shifted. Where the courts are automatons, they hold the administrators in line; neither courts nor administrators have much freedom; and the tasks of judgment and decency are left in the hands of Congress. But where the interpretative jurisdiction is enlarged and policy judgments are made by the courts and the administrative officials, the jurisdiction of Congress is correspondingly narrowed. This accomplishes a shift of responsibility.

Mr. Justice Reed in *United States* v. *American Trucking Associations, Inc.*[109] mentions the "danger that the courts' conclusion as to legislative purpose will be unconsciously influenced by the judges' own views or by factors not considered by the enacting body," and adds, "A lively appreciation of the danger is the best assurance of escape from its threat but hardly justifies an acceptance of a literal interpretation dogma which withholds from the courts available information for reaching a correct conclusion." It would be healthy if there were more general awareness of new responsibility. When the courts and the administrative officials make policy judgments, they should know what they are doing; [110] for they are faced with the difficult problem of determining when far is too far. In short, if the courts and the administrative officials are to increase their legislative function, they should be prepared to act in a statesman-

[106] Holmes, J., dissenting in *Southern Pacific Co.* v. *Jensen*, 244 U. S. 205, 221 (1917).

[107] *Helvering* v. *Wood*, 309 U. S. 344, 347 (1940).

[108] See also Mr. Justice Black's dissent in *Royal Indemnity Co.* v. *United States*, 313 U. S. 289, 297 (1941), concurred in by Mr. Justice Douglas and Mr. Justice Murphy, objecting to the majority conclusion (that the 6 per cent New York interest rate should be applied to the liability of a surety) on the ground that the majority opinion was "judicial law-making."

[109] 310 U. S. 534, 544 (1940). See also Pound, "Spurious Interpretation," 7 *Col. L. R.* 379, 386 (1907).

[110] Cardozo, *The Growth of the Law*, p. 107 (1924), quoting Pound, "The Theory of Judicial Decision," 36 *Harv. L. R.* 940, 959 (1923).

like way. The normal legislative process, somewhat in the manner of a jury, affords a large measure of protection to the citizen. With a diminished legislative responsibility that protection is gone. With a new freedom for the interpretative process we need an increasing consciousness of responsibility in the judicial and administrative process to afford like protection.

There are two extremes of attitude in statutory interpretation. The court may passively bow its head, obeying the literal language of the statute and blaming Congress for inept legislation.[111] This would be an adoption of Chief Justice Marshall's notion, repudiated in practice by him,[112] that "Courts are the mere instruments of the law, and can will nothing"; [113] it is what Professor Corwin calls "judicial automatism." [114] It would pass the responsibility to Congress, which sooner or later would be obliged to undertake more efficient legislation. The other extreme would be judicial legislation running riot; [115] one eminent commentator has said that judicial usurpation "may take the form of acting in place of Congress as well as of putting chains on Congress." [116] The temperate and attractive alternative is to give to statutes the creative treatment described by Mr. Justice Holmes in *Johnson* v. *United States*,[117] and recently again described by Mr. Justice Reed in *United States* v. *American Trucking Associations, Inc.*[118] This consists of searching in inarticulate statutes, and even sometimes in superficially plain statutes, for the major premise of the conclusion expressed, the policy which induced the enactment, and trying to give effect to that premise and policy. Only so may we achieve "the ideal of a unified system of judge-made and statute law woven into a seamless whole by the processes of adjudication." [119]

111 This the court now does when exemption or deduction provisions are inadequately written.

112 See above, p. 134.

113 *Osborn* v. *United States Bank*, 9 Wheat. 738, 866 (U. S., 1824).

114 Corwin, *The Twilight of the Supreme Court*, p. 114 (1934).

115 *Schechter Poultry Corp.* v. *United States*, 295 U. S. 495, 553 (1935). "Words are certainly not crystals, as Mr. Justice Holmes has wisely and properly warned us, but they are after all not portmanteaus." Radin, "Statutory Interpretation," 43 *Harv. L. R.* 863, 866 (1930).

116 Powell, Book Review, 152 *The Nation*, No. 10, pp. 273, 274 (1941).

117 163 Fed. 30, 31-2 (CCA 1st, 1908), later decision 170 Fed. 581 (CCA 1st, 1909). See also Stone, "The Common Law in the United States," 50 *Harv. L. R.* 4, 112 (1936); de Sloovère, "Extrinsic Aids in the Interpretation of the Statutes," 88 *U. of Pa. L. R.* 527, 532 (1940).

118 310 U. S. 534, 542 (1940), citing many tax cases.

119 Stone, "The Common Law in the United States," 50 *Harv. L. R.* 4, 12 (1936).

CHAIRMAN GERSTENBERG: Thank you, Mr. Paul.

I sometimes wonder what is meant by that saying, "Mahomet comes to the mountain, or the mountain goes to Mahomet," but the next speaker illustrates very clearly that sometimes the mountain goes to Mahomet. We are the mountain, and certainly the next speaker is Mahomet. He is right at home. I take great interest in introducing or presenting right now our good friend Henry Rottschaefer, Professor of Law at the University of Minnesota, who will speak on the Important State Court Decisions.

HENRY ROTTSCHAEFER: Mr. Chairman, after an introduction of that sort one hardly knows whether to feel modest or to feel that one has been put to a task that is impossible to perform. I shall allow the audience to be the judge of that.

As I understand it, this review of State Tax Decisions is a sort of departure from the customary routine of this Association. Whether it represents progress or retrogression, is again something which is not for me to determine.

REVIEW OF STATE TAX DECISIONS

HENRY ROTTSCHAEFER

University of Minnesota Law School

The previous speakers have dealt with subjects that bear on tax problems whose importance is independent of state lines. The character of this Association demands that the discussion of the decisions of the state courts in the field of state taxation achieve that same quality as nearly as the subject-matter permits. It is reasonably certain that this can best be accomplished by selecting decisions that deal with problems that might arise either in all of the states or in a considerable number of them. The adoption of this principle of selection will certainly exclude many decisions that loom large in the tax laws of the states by whose courts they were rendered. The suggested course has, however, been followed in the presentation of the assigned subject. There is one further prefatory remark necessary for a proper understanding of what follows. The decisions have been studied from the point of view of their significance for determining whether they evidence any such general trends as previous speakers have discovered in the decisions of the Supreme Court of the United States. It is recognized that a survey of a longer period than a year, or even a few years, would be required to justify a definite conclusion on the extent and direction of any trend that might be discovered. Accordingly, I shall, when discussing this aspect of the subject, not only proceed with caution but indicate the extent to which any statements made reflect interpretations of decisions of prior years. Most of the decisions that will be considered

were rendered during the last fifteen months, and all of them were made since the beginning of the calendar year 1940.

It is, of course, a legal truism that the states may levy taxes for public purposes only. Students of this doctrine had long been aware of the fact that the concept, "public purpose", was largely a function of general theories as to the proper and legitimate field of governmental action. It was, therefore, inevitable that its scope should expand during the present period when the pressure of events resulted in both an expansion of governmental activities and the development of judicial philosophies that made it relatively easy to sustain that expansion against all manner of constitutional objections. It is against such a background that decisions in numerous cases prior to 1940 sustaining the use of the states' taxing powers to finance housing and slum clearance projects seem but a natural evolution of the "public purpose" doctrine.[1] It is almost inconceivable that any state court should today refuse to follow that trend. A recent case has, indeed, held that the taxing power was being used for a public purpose when used to finance a program for building houses in rural communities to be rented to landowners, tenants, sharecroppers, and wagehands in low-income groups.[2] The court refused to limit the general principle because some of the arguments that had been used to sustain such projects in urban areas were inapplicable to a rural housing scheme. The theory of public purpose implicit, and sometimes made explicit in judicial opinions, is a far cry from the narrow theory that once led to the decision holding that the public credit was being used for private purposes when used to finance the reconstruction of an area destroyed by fire.[3] A recent Michigan decision sustained as for a proper public purpose a tax levied upon apple-growers to finance the activities of a public commission in creating markets for Michigan apples in other states.[4] The tax had been assailed as constituting a subsidization of private industry from public funds, but the court deemed it a sufficient answer to that charge that the funds were being expended by a public body to finance its own activities. The requisite public purpose was found in the fact that such expenditures would promote the general welfare by promoting the welfare of the industry. The interesting point of this decision is that it affords a method by which a state can in effect compel those engaged

[1] See *Rutherford* v *City of Great Falls*, 86 P. (2nd) 656 (Mont. 1939); *Krause* v *Peoria Housing Authority*, 19 N. E. (2nd) 193 (Ill. 1939); *Housing Authority, Etc.* v *Dockweiler*, 94 P. (2nd) 794 (Cal. 1939).

[2] *Benjamin* v *Housing Authority of Darlington County*, 15 S. E. (2nd) 737 (S. C. 1941).

[3] *Lowell* v *Boston*, 111 Mass. 454 (1873).

[4] *Miller* v *Michigan State Apple Commission*, 296 N.W. 245 (Mich. 1941).

in a given industry to submit to forced expenditures for the promotion of sales beyond the state's borders, or, for that matter, within the state itself. It is at least desirable that the costs of such public activities should be borne, as they were in this case, by their principal direct beneficiaries. On the whole it can be stated that taxpayers in the future will find it about as futile to assail a tax in a state court on the score that it is not for a public purpose as it has for years been to do so in the United States Supreme Court.

The constitutions of practically every state contain provisions intended to secure a measurable degree of uniformity in spreading the tax burden. These uniformity clauses, even when applicable to all taxes, are construed to require uniformity only within each class of tax. They do not compel a state to tax all conceivable tax subjects if it decides to tax any, nor do they require any particular relation between the taxes imposed upon one class of tax subjects and those imposed on another class. They do, however, limit the legislatures in selecting what subjects shall be subjected to a particular type of tax. The courts have in the past been quite liberal in sustaining tax classifications, and the present tendency is to become even more so. There have been no significant decisions in this field during the period herein covered. There is, however, one form of classification in connection with which several interesting cases have been decided. That is the granting of exemptions from taxation. The constitutions of many states restrict their legislatures in granting exemptions from property taxes by specific provisions in addition to their uniformity clauses. A common provision of this type is that which either specifies that certain property shall be exempt or that confer upon the legislature the power to exempt specified classes of property. These provisions have generally, though not universally, been construed to prevent legislative exemptions not specified therein. This has led at times to attempts at their total or partial circumvention by devising systems of "lieu taxation". A recent Arizona case definitely scotched such an attempt, although the object aimed at by the statute was undoubtedly a worthy one. A statute of that state levied a motor vehicle license tax payable when the vehicle was registered for operation over the state highways, the tax being proportionate to the fraction of the year during which it was registered. The tax was made in lieu of the ad valorem tax on such vehicles. The court held that the substitution of the excise tax for the ad valorem tax constituted an exemption, and that the grant of such exemption violated the constitutional provision limiting exemptions to specified property which did not include such vehicles.[5] A constitutional amendment was required to enable the state to obtain the system for taxing motor vehicles which the people of the

[5] *Miners & Merchants Bank* v *Bd. of Supervisors*, 55 Ariz. 357, 101 P. (2nd) 461 (1940).

state wished to have.[6] Another attempt at circumventing that same inconvenient constitutional limitation is illustrated by the case of *State* v *Yuma Irrigation District*.[7] The legislature had, in creating that district, exempted its property from taxation, and, in the hope of making that exemption effective, declared such district to be a municipal corporation for tax purposes. The constitution expressly exempted the property of such corporations. The attempt was defeated by a court that denied that the legislature could give such district the character of a municipal corporation in the face of long-recognized views and decisions to the contrary. These decisions accord with what is undoubtedly the weight of authority, as do those holding that a legislature is limited by the states' uniformity clause in exercising whatever power it has under the state constitution to grant exemptions from taxation. It was on the latter theory that the Arizona court stated that the exemption of motor vehicles from property taxes upon payment of a substitute license tax would be invalid because the substitute was based on the period for which the vehicles were registered.[8] The same principle is invoked to so construe a statutory exemption of property held for the benefit of educational institutions where the income therefrom was used exclusively for educational purposes, as to exclude the exemption of an office building owned by a college even though the rents were used exclusively for educational purposes.[9] The theory of the decision was that it would be an arbitrary discrimination to exempt such business property while taxing such property generally. The same desire to prevent invidious distinctions in granting exemptions led another court to hold that a constitutional provision requiring property to be assessed under general laws by uniform rules was violated by excluding the property of college fraternities from an exemption accorded the property used for the purposes of fraternal organizations.[10] It may safely be said that state decisions on these constitutional phases of the problem of tax exemptions follow long-established principles in a manner that facilitates accurate prediction of the results of future cases. This is equally true in general of the decisions construing the scope of legislatively conferred exemptions. There are no cases worth discussing in this brief review.

There are two cases that deserve at least a brief notice. In the first, the Supreme Court of Missouri once again held violative of the

[6] *McAhrens* v *Bradshaw*, 113 P. (2nd) 932 (Ariz. 1941).

[7] 99 P. (2nd) 704 (Ariz. 1940).

[8] See Note 5, *supra*.

[9] *Rockingham County* v *Bd. of Trustees of Elon College*, 13 S. E. (2nd) 618 (N. C. 1941); see also *Trustees of Guilford College* v *Guilford County*, 13 S. E. (2nd) 622 (N. C. 1941).

[10] *Alpha Rho Alumni Assn.* v *City of New Brunswick*, 18 A. (2nd) 68 (N. J. 1941).

contract clause an attempt to tax certain of the property of Washington University in St. Louis, Missouri, which has for nearly a century enjoyed contractual immunity from the taxation of all property owned by it.[11] The case is of interest because of the arguments advanced by counsel for the city who were confronted with a decision of the Supreme Court of the United States which would control the instant case.[12] Its controlling effect was sought to be obviated by the theory that the question of whether the university's charter constituted a contract was again open for determination under the doctrine of *Erie R. Co.* v *Tompkins*.[13] The court made short shrift of this argument, and correctly so. Counsel had also argued that the legislature which granted the charter had had no power to make a contract perpetually exempting the university's property from taxation. Unfortunately, the court did not discuss this point. It is quite apparent that states that still find themselves bound by contracts granting perpetual exemptions from taxation can expect no relief from the presently burdensome consequences of their earlier generosity unless the federal Supreme Court intervenes by applying to the states' taxing powers the doctrine developed by that court with respect to their police powers, namely, that states may not thus perpetually bargain them away. It is not at all improbable that the Supreme Court, as presently constituted, will, if given the opportunity, do just that. However, it has not yet done so. The second case of interest arose in Pennsylvania, and involved the validity of applying the Philadelphia ordinance taxing the compensation earned by residents, and by non-residents so far as earned within the city, to the salary of a state employee engaged within the city in the performance of governmental functions. The employee's counsel had contended that the doctrine of "governmental immunity" prohibited a municipality from taxing the salaries of state employees. The court dignified the argument with more discussion than it merited, but naturally rejected it.[14] One marvels at the nerve of counsel who would extend the scope of a doctrine beyond limits even given it at the very time when those limits are being more and more contracted.

I shall next consider some recent decisions in the field of state inheritance taxation. The extent of a state's jurisdiction to impose such tax on the transfer of intangible personalty will not be fully clarified until the federal Supreme Court indicates some more definite principle than it has done in *Curry* v *McCanless*[15] and *Graves*

[11] *Washington University* v *Gorman*, 153 S. W. (2nd) 35 (Mo. 1941).

[12] *Washington University* v *Rowse*, 8 Wall. 439 (U. S. Sup. Ct. 1869).

[13] *Erie Railroad* v *Tompkins*, 304 U. S. 64 (1938).

[14] *Marson* v *Philadelphia*, 21 A. (2nd) 228 (Pa. 1941).

[15] *Curry* v *McCanless*, 307 U. S. 357 (1939).

v *Elliott*.[16] There is but one case during the period under review that needs to be noted. The decedent was domiciled in Colorado at all times relevant to the tax issue, including the date of his death. He had made an *inter vivos* transfer to trustees, one of whom was a resident of the state and the other a New York trust company with which the trusteed securities were kept. The terms of the transfer brought it clearly within the class of transfers intended to take effect in possession or enjoyment at or after his death. The Colorado law in force at the time of settlor's death taxed such transfers, but exempted gifts to educational institutions even if located in other states. Under the terms of the transfer a remainder to the University of Vermont was limited to take effect in possession on the death of the settlor's wife who in fact survived him. After his death but prior to that of his widow the tax act was amended by removing the exemption of gifts to out-of-state educational institutions. The amendment was made applicable to the estates of decedents dying prior to its enactment so far as such estates remained undistributed at that date. The decedent's estate was in that class so far as the gift to the University of Vermont was concerned. The state accordingly imposed the tax on that gift. The situation was clearly one in which the state had jurisdiction to impose the tax under the principles of *Curry* v *McCanless*. The executor admitted this so far as the application of the law in force at the time of decedent's death was concerned. He argued, however, that on that death the decedent's interest in the trust res ended, and that said res was thereafter beyond Colorado's power to tax. The court's rather categorical answer was that jurisdiction depended wholly upon the factor of decedent's domicile at his death, and not at all upon the situs of the res at any time.[17] The decision is undoubtedly sound, the more so because under the trust instrument no transaction involving the trust could be undertaken after the settlor's death without the consent of the Colorado co-trustee. No case has been found that adds to our knowledge of just what acts of a decedent will suffice to give intangibles that kind and degree of connection with a state, other than that of his domicile, which will give that state the power to impose its inheritance tax upon their transfer on decedent's death. The whole problem of multi-state inheritance taxes confronts us once more.

In the case just discussed, the imposition of the tax on the gift to the University of Vermont under a statute enacted after the settlor's death was also sustained against the claim that it imposed taxes retroactively in violation of the contract clause and the due process clause of the 14th amendment of the federal constitution. The court correctly applied the doctrine that a tax may be imposed

[16] *Graves* v *Elliott*, 307 U. S. 383 (1939).

[17] *People* v *Waterman's Estate*, 116 P. (2nd) 204 (Colo. 1941).

at any time before the succession to the beneficial enjoyment of the property is complete, even though the interest in the property was vested in title prior thereto. A Kentucky court sustained against the same objections the application of a statute subjecting the receipt of the proceeds of insurance policies taken out by the decedent on his own life to policies taken out prior to the statute's enactment by a decedent who died thereafter.[18] In this particular field, the decisions accord with earlier decisions.

The important decisions involving the issue of what transfers are taxable have been relatively few. It was held in one of them that the assets in which a decedent's executor had invested the amount of a federal estate tax refunded to him in 1926, when the rates of that tax were retroactively lowered, constituted a part of the estate in computing the state's inheritance tax due in 1939 when remaindermen under a trust established by decedent's will came into possession thereof.[19] The court's principal reason in support of this eminently sound and just holding was that only thus could the aim be realized which the state had in mind in permitting the deduction of the federal estate tax in computing the inheritance tax due it. The Massachusetts' court had some difficulty in distinguishing two of its earlier decisions, but did so, at least to its own satisfaction. The majority of the decisions have involved the scope of the provision taxing transfers intended to take effect in possession or enjoyment at or after the grantor's death. A Massachusetts decision reaffirms that state's refusal to tax the receipt of the proceeds of an insurance policy on decedent's life under this provision of the statute.[20] In the case in question the decedent had transferred the policy to a trustee to collect the proceeds for the benefit of designated persons, and had retained the power to revoke the trust and to avail himself of many benefits in respect to and under the policy. The court held that the adoption of this device did not prevent the application of the general rule, since the rights of the trustee and the cestuis became effective when the policy was deposited with the trustee. It expressly declined to follow the New Jersey case of *Fagan* v *Bugbee*[21] and the federal estate tax decision of *Chase National Bank* v *United States*.[22] Nor was it sufficiently impressed by recent trends of ignoring technicalities and looking to results in tax cases to depart from its own prior rule. A New Jersey case followed the lines of that state's consistent policy and sustained a tax on the commuted value of installments due after decedent's death under a refund annuity

[18] *Dumesnil* v *Reeves*, 142 S. W. (2nd) 132 (Ky. 1940).

[19] *Safe Deposit & Trust Co.* v *Com'r of Corporations & Taxation*, 33 N.E. (2nd) 704 (Mass. 1941).

[20] *Welch* v *Com'r of Corporations & Taxation*, 34 N.E. (2nd) 611 (Mass. 1941).

[21] *Fagan* v *Bugbee*, 105 N. J. L. 85 (1928).

[22] *Chase National Bank* v *United States*, 278 U. S. 327 (1929).

purchased by him.[23] The purchase was held a transfer intended, etc. The court furthermore declined to exempt it under the provision of the statute expressly exempting the proceeds of life insurance policies paid to named beneficiaries on the score that the annuity contract was not an insurance contract. The decision is sound in both respects. For the rest, the decisions follow such well-established interpretations of this statutory provision as to require no comment. It is, however, of some interest to note that the Supreme Court of Utah held the corpus of a trust includible in the settlor's gross estate in computing what it called an estate, as distinguished from an inheritance, tax. The settlor had reserved a life estate, which would have made it clearly a transfer intended, etc., under state inheritance tax decisions. The executor had contended that those decisions were not in point because the state's tax was an estate tax, and relied upon *May* v *Heiner*[24] to support the exclusion of the corpus from the settlor's gross estate. The court, however, preferred to follow state inheritance tax decisions.

The need for revenues has led some states to adopt gift taxes. The tax is generally imposed on the donee. Cases arising under them are certain to increase as time goes on. I shall briefly discuss three decisions from Wisconsin. The issue of the state's jurisdiction to impose such tax upon gifts by residents was raised in two of the cases. The donor in both made the actual transfer in another state to which he had gone for that very purpose. The court held that Wisconsin had jurisdiction in both cases founded on the fact that it was the state of the donor's domicile.[25] No one can reasonably doubt that its position will be sustained by the United States Supreme Court if an appeal should be taken to it. In one of those cases, the question of whether there had been a gift was also in issue. On that point the court limited taxable gifts to those in which the donor had completely and irrevocably disposed of the interest sought to be taxed. It was held that there had been no gift because the donor had reserved a measurable degree of control over the property transferred.[26] It is interesting to note that the court considered it immaterial whether that control had been reserved for the benefit of the donor or of others. In the last of the cases the question was one of valuation of the gift. The donor had transferred property to a trustee to accumulate the income for his life, and on his death to pay over the corpus and accumulated income to the donor's wife. The taxing authorities valued the gift at the full value of the property at the time of the gift. The taxpayer

[23] *In re Atkins' Estate*, 18 A. (2nd) 45 (N. J. Prerog. 1941).

[24] *May* v *Heiner*, 281 U. S. 238 (1930).

[25] *Van Dyke* v *Wisconsin Tax Commission*, 292 N.W. 313 (Wis. 1940); *In re Ingram*, 295 N.W. 749 (Wis. 1941).

[26] *In re Ingram*, 295 N. W. 749 (Wis. 1941).

claimed that, since the gift was of a future interest, it should be valued at its discounted present worth. The court sustained the taxing authorities for the reason that the gift was of the corpus and the income for the period during which the donee's possession was in abeyance, and that the combined discounted values of these two elements equalled the market value of the corpus at the date of the gift.[27] No fault can be found with this analysis.

It is a rather remarkable fact that there are so few state court decisions involving state income taxes or franchise taxes measured by income. Those which I have chosen to consider may be conveniently grouped into (a) those concerned with the territorial source or "situs" of income; (b) those defining income; and (c) those dealing with permissible deductions in arriving at net income. State income taxes on non-residents, and in some cases on residents, are based on income from sources within the taxing state. The question of when income may be deemed to be from that source has been decided in several recent cases. It has been held that dividends on the shares of a domestic corporation owned by a non-resident, but held by a bank within the taxing state subject to a naked trust for the benefit of the non-resident beneficial owner, are not from local sources.[28] The shares were considered the source of the income, and these were held to have their situs at the domicile of the non-resident owner. A wholly different conception of the source of dividend income is found in a Missouri case. The dividends had been received by a Missouri corporation on shares in a foreign corporation that did no business within Missouri. They were includible in the domestic corporation's gross income only if from Missouri sources. The court construed the source of income to mean the place in which it was produced, and held that the dividends were not from Missouri sources.[29] This conflict at least suggests the desirability of including in state income tax laws express specific provisions determining the source of the several different types of income. The determination of the income allocable to a given state in the case of a unitary business conducted in more than a single state is a problem familiar to all. The general principles governing it require no discussion here. In one recent case, the state's use of the "unit rule" resulted in charging a foreign corporation engaged in the wholesale business with income earned within the state, although a separate accounting for the local branch showed an operating loss. The local branch had been charged with its proportionate share of the corporation's general overhead. The taxpayer objected to the method used by the state on the score that due process was being denied it by the mere use of the "unit rule

[27] *Miller* v *Wisconsin Dept. of Taxation*, 299 N.W. 28 (Wis. 1941).

[28] *Robinson* v *McColgan*, 110 P. (2nd) 426 (Calif. 1941).

[29] *Union Electric Co.* v *Coale*, 146 S.W. (2nd) 631 (Mo. 1941).

system". The state's method was sustained.[30] The centralized buying for all branches was held so similar to centralized production as to make the case to be governed by decisions sustaining the use of the unit rule where goods are produced in one state and marketed in many states. No higher court is likely to reverse this decision.

The problem of whether given receipts constitute income seems to have given rise to very little litigation during the period covered. In one case, liquidating dividends were held not to constitute dividends under a statute defining income as including dividends.[31] No attempt was made to tax any existing gain accruing as a result of the distribution since the tax act expressly excluded capital gains from income. In another case, a tax on capital gains from the sale of capital assets after the effective date of the tax act, but under an option given prior thereto, was held not a tax on capital but on income.[32] The same case also held that the due process clause of the 14th amendment to the federal constitution was not violated by making an income tax act retroactive to the beginning of the calendar year in which the act was passed. It will be noted that the results of these decisions accord with decisions involving similar issues under federal income tax acts, and the court in the last case relied to a considerable extent upon federal decisions. The decisions concerning deductions have involved business expenses, taxes, and depletion. The Supreme Court of Oklahoma has treated as an ordinary and necessary business expense a payment made by a corporate taxpayer in settlement of a tort action brought against it as the beneficiary of the fraud of certain individuals who had organized it as part of their scheme for defrauding the plaintiff.[33] The court also refused to hold it non-deductible because the commission of the tort was against public policy. In a West Virginia case, the court refused to permit taxes, of a kind not includible under the express provision permitting certain taxes to be deducted, to be deducted as ordinary and necessary business expenses.[34] It took the position that a tax constitutes such an expense only if it is really a regulatory charge. The taxes held not deductible included state and federal social security taxes, and the exaction made under the federal Bituminous Coal Act. Part of the court's reasoning is rather unconvincing. Another case involved an attempt by the taxpayer to deduct, in one year, back taxes for ten preceding years on intangibles which she had failed to report for taxation during

[30] *Butler Bros.* v *McColgan*, 111 P. (2nd) 334 (Calif. 1941).

[31] *Lynch* v *State Board of Assessors*, 291 N.W. 161 (Ia. 1940).

[32] *Holmes* v *McColgan*, 110 P. (2nd) 428 (Calif. 1941).

[33] *Hales-Mullaly, Inc.* v *Oklahoma Tax Commission*, 100 P. (2nd) 274 (Okla. 1940).

[34] *Christopher* v *James*, 12 S. E. (2nd) 813 (W. Va. 1941).

those years.[35] The attempt failed because the court held that the legislature never intended that a taxpayer guilty of negligence or fraud in escaping taxes during earlier years should be permitted to benefit by the wrong thus perpetrated. The decision undoubtedly accords better with sound morals than with ordinary principles for construing statutory language. It is seldom that a federal income tax decision is as fully accepted, as decisive of an issue arising under a state income tax act as was the case of *Atlas Milling Co.* v *Jones* in a recent Oklahoma case.[36] In that case, the extraction of minerals from tailings after the milling of ores was held not to constitute the operation of a mine entitling the operator to take a depletion deduction.[37] The foregoing cases practically exhaust the important state income tax decisions during the period under review.

Time permits only the merest reference to state decisions involving other types of state taxes. An interesting sales tax decision is that by the Supreme Court of North Dakota holding that a photographer makes a taxable sale of tangible personal property in making and delivering to patrons who have sat for their photographs the finished photos made on their order.[38] It was, however, held that the charges made specifically for the sitting need not be included in the sale price unless that method is resorted to for purposes of evading the tax. This appears to be the first decision on these points. The only other case worth noting is one in which the Kansas Supreme Court held that the consideration received by an insurance company for immediate life annuities and deferred life annuities constituted premiums paid on insurance contracts and thus includible in computing the state tax on gross premiums.[39] This position is contrary to the weight of authority, and represented a change in a long-continued policy of the taxing authorities of the state. A Missouri decision made during 1941 is in accord.[40] The three decisions herein considered reflect a tendency on the part of the courts to give less effect to the alleged principle that taxing statutes are strictly construed against the taxing authorities.

It is quite apparent from the foregoing review of state decisions during the last year and a half that state courts are undoubtedly becoming more liberal in construing those constitutional limitations upon the taxing power that are framed in vague and ambiguous terms. It is equally clear that, by and large, they reflect no judicial

[35] *Bigelow* v *Reeves*, 149 S. W. (2nd) 499 (Ky. 1941).

[36] *Atlas Milling Co.* v *Jones*, 115 Fed. (2nd) 61 (1940).

[37] *Lawyers Lead & Zinc Co.* v *Tax Commission*, 111 P. (2nd) 1085 (Okla. 1941).

[38] *Voss* v *Gray*, 298 N. W. 1 (N. D. 1941).

[39] *Equitable Life Assurance Society, Etc.* v *Hobbs*, 114 P. (2nd) 871 (Kan. 1941).

[40] *State* v *Lucas*, 153 S. W. (2nd) 10 (Mo. 1941).

trend towards forced constructions of constitutional provisions not so vaguely phrased. The highest courts of the several states have, in general, refused to invent tortured constructions of taxing statutes in order to increase the revenue or to carry out a social policy of redistributing wealth and income that the legislatures have not clearly required. In this respect their actions have afforded a pleasant contrast with those of the United States Supreme Court since it has become super-conscious of the federal government's need for additional revenues. For that, our state courts merit our commendation.

Chairman Gerstenberg: I am sure that we are all happy to have that paper by Professor Rottschaefer on state court decisions.

I am asked to make this announcement: a meeting of the executive committee at 5:30 in Room 1100. All members who have not registered—this applies to members of the association—please do so immediately at the end of this session.

We have only one more paper, and I am sure that all of you will want to hear it, because it is given by a new friend. We in New York feel that all institutions are but lengthened shadows of men, and our old friend Mark Graves has tried very hard to see that the National Tax Association gets to know the good men of his commission. You will remember Ogden Ross, who in the course of only fifteen minutes became a friend of everybody. I think pretty nearly everybody called him "Ogden." I am very sorry that he had to leave us and go into the Army, but I am sure that we will all be happy to know his successor, Commissioner Joseph M. Mesnig, who is going to talk on the Buck Resolution.

Joseph M. Mesnig: Thank you.

Dr. Gerstenberg, Members of the National Tax Association: I am very certain that all of you are so intimately, so pleasantly acquainted with the President of the New York State Tax Commission, Mr. Mark Graves, that you will be very happy to have me tell you that he has very substantially, if not completely, recovered from his recent indisposition. Only the prescription of his doctor that he forego the rigorous travel necessary to get here made him forego that pleasure. Otherwise, I know that he would have been here to attend these deliberations.

The title of this paper is the Buck Resolution, and as I thought a little more about it, I believe that is something of a misnomer. Pretty generally and popularly this piece of legislation is known as The Buck Resolution, but for the sake of strict accuracy it is an Act of Congress and approved by the Executive and therefore should be known as the Buck Act rather than the Buck Resolution.

THE BUCK RESOLUTION

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One of the most vexing problems to state tax administrators in the field of intergovernmental immunity has been the question of the imposition of state taxes on activities and transactions in federal areas. The states have been continually confronted by the question whether they have territorial jurisdiction over certain areas within their boundaries which have been acquired by the United States either by cession, purchase or condemnation. The determination whether the jurisdiction of the United States over such an area is exclusive, or concurrent with that of the state, has been beset with many difficulties, and controversies involving the right of a state to levy a tax upon activities and transactions within such an area have frequently reached the United States Supreme Court. Quite recent examples are the *Dravo* and *Silas Mason* cases in 302 U. S., dealing with state taxation of contractors performing work for the Federal government within areas over which that government had acquired varying degrees of jurisdiction. A graphic illustration of the question is whether a sale of liquor consummated by delivery to a person in any United States post-office building or to any federal building is subject to state taxation. Many tax administrators will recall the myriad of inequities in the sale of gasoline for private use in federal areas.

This particular problem was further complicated by the Public Salary Tax Act of 1939 under the provisions of which the United States consented to the taxation by the states, under certain circumstances, of the compensation of federal employees. The application of the provisions of that act resulted in anomalous situations. For example, the compensation of a naval officer who was ordered to the Naval Academy for duty, and who happened to reside in quarters assigned to him within the Naval Academy grounds, could not be subjected to a state income tax by Maryland because the Naval Academy was a federal area over which the United States had exclusive jurisdiction. However, the compensation of a fellow officer, who had also been ordered to the Naval Academy for duty and who rented a house in the state outside the Academy grounds could be taxed. Again, a typical example of inequity, in fact, absurdity, is seen in the case of an internal revenue agent resident in New Jersey who contends that his compensation earned while doing desk duty in a federal building in New York is free from a New York income tax, but concedes that salary earned from field duty in the state is subject to the state tax.

In 1936, the Hayden-Cartright Act (c. 582, section 10, 49 Stat. 1521) solved a few of these problems. It permitted the imposition of state taxes on motor fuels when sold by or through post exchanges, ship stores and other similar agencies located on United States military or other reservations when such fuels were not for the exclusive use of the United States. It was not until 1940, by the Buck Resolution (Public No. 819), that most of these uncertainties and inequities were removed.

Under its provisions, the United States, in effect, waived exclusive jurisdiction over federal areas, with respect to sales, use and income taxes, as defined, and acknowledged that the several states, and all taxing authorities therein, had jurisdiction to levy and collect any such tax in any federal area within the state to the same extent and with the same effect as though such area was not a federal area.

While the Buck Resolution has solved many of the problems, it has also created new ones. The resolution expressly provided that it should not be deemed to authorize the levy or collection of any tax on or from the United States or any instrumentality thereof, or any tax on or from any Indian not otherwise taxed, or the levy or collection of any tax with respect to the sale, purchase, storage or use of tangible personal property sold by the United States or any instrumentality thereof to any authorized purchaser. Although it had no difficulty in the Hayden-Cartright Act in recognizing that post exchanges were not federal instrumentalities, the Congress expressly left open in the Buck Resolution the question of whether such exchanges were federal instrumentalities (Report No. 1625, 76th Congress, 3rd Session). It was thus inherent that this problem be settled by the courts.

The first case to reach the courts, involving the question was *United States* v. *Query* (37 F. Supp. 972). South Carolina imposes a license tax for the privilege of engaging in the sale of certain articles within the state, including beer, wine, tobacco products, soft drinks, playing cards and candy. After the effective date of the Buck Resolution, the South Carolina Tax Commission attempted to collect such a tax from the United States Army post exchanges at Fort Jackson. An Army post exchange is, ordinarily, an unincorporated association which is created and functions under United States Army regulations promulgated by the Secretary of War. It is operated for the primary purposes of selling to soldiers, at minimum prices, certain articles of daily use which are not supplied to them by the government, affording soldiers means of recreation and amusement, and, when necessary, applying its profits to the improvement of company messes. It also provides financial support necessary for the maintenance of recreational facilities, entertainments, clubs and libraries, and is governed by a council consisting of a post exchange officer and the commanding officer of each army unit participating therein.

The commanding general and post exchange officer at Fort Jackson brought an action in the United States district court for a declaratory judgment and for an injunction. The district court held that an Army post exchange was an instrumentality of the United States within the meaning of the Buck Resolution, and granted the injunction. The Circuit Court of Appeals for the Fourth Circuit affirmed on June 27, 1941.

The *Query* case was followed by a United States district court decision in Kentucky which recently held, in *Falls City Brewing Co., Inc.* v. *Reeves*, that the post exchange at Fort Knox was a federal instrumentality which was not required to obtain a state license to sell malt beverages, and that sales to it for resale to authorized purchasers were not taxable. The court indicated that the Buck Resolution was passed for the purpose of placing licensed traders in federal areas on the same competitive basis as traders outside such areas and that its provisions preserved the exemption of sales to or by post exchanges.

The attorneys general of several states do not agree with the view that a post exchange is a federal instrumentality. For example, the attorney general of Texas is of the opinion that a post exchange is not immune from cigarette stamp taxes upon either the sale in Texas of cigarettes to the exchange by licensed distributors, or the sale of imported cigarettes by such exchange to Army personnel. In my own state, the attorney general is of the opinion that post exchanges are not such federal instrumentalities that the purchase by them of alcoholic beverages, cigarettes, etc., for purposes of resale to Army personnel is exempt from state tax, and has said that:

> ". . . The unmistakable trend of recent decisions and legislation seems to compel such a conclusion, as revealing a fundamental movement toward a re-examination of former immunities and exemptions; the end result has been a general broadening of intergovernmental tax jurisdiction generally, the dividing line being found where taxation directly burdens a governmental function.
>
> ". . . The application of a general tax upon sales of alcoholic beverages, cigarettes, etc., to Post Exchanges for the purpose of resale by the Exchange cannot, in my view, operate to burden or impede the operations of the Federal Government."

The confusion and uncertainty attendant upon the question whether post exchanges are federal instrumentalities and hence within the exemption in the Buck Resolution has caused some states to break the Gordian knot by legislation. Pennsylvania, for instance, provides that commissaries, ships' stores and voluntary unincorporated organizations of the Army or the Navy personnel operating under regulations promulgated by the Secretary of War or the Secretary

of the Navy, may engage in the sale of cigarettes at retail without procuring a license, and further provides for the exemption from tax of sales of cigarettes made to authorized purchasers by such commissaries, stores and organizations. No license is required by New Jersey for the retail sale of alcoholic beverages for consumption on the premises of any camp, post or regimental exchange organized under the regulations of the United States Army or Navy or Marine Corps, where consent of the State Military Board has been obtained. New York has expressly exempted from the cigarette tax and the tax on alcoholic beverages, sales by or to voluntary unincorporated organizations of Army or Navy personnel operating an establishment for the sale of such goods pursuant to regulations promulgated by the Secretary of War or the Secretary of the Navy.

The question whether the several states may constitutionally tax the activities of commissaries and post exchanges operating in federal areas is but one phase of the problem. A more difficult question is presented in cases, now arising with increasing frequency, where state taxes are imposed upon contractors performing a contract with the United States on a cost-plus-fixed-fee basis. Such contractors ordinarily work under the immediate supervision of agencies of the United States, and their contracts expressly provide that title to all work, materials and equipment, for which the contractors are reimbursed, vests in the United States. In *King and Boozer v. State of Alabama*, decided by the Alabama Supreme Court on July 29th of this year, the primary question presented was whether Alabama could constitutionally impose a sales tax with respect to sales of materials made to a cost-plus-fixed-fee contractor who was engaged in the construction of a camp at Fort McClellan. A further question presented was whether it could impose such a tax upon sales which were consummated at the fort, which was in a federal area, and whether the Buck Resolution waived exclusive jurisdiction over such area in so far as such sales were concerned. In this particular case, the contract expressly provided for the reimbursement of payments made by the contractor under the Social Security Act and "any applicable State or local taxes, fees or charges which the contractor may be required to pay on or for any plant, equipment, process, materials, supplies, or personnel"; the court held that the imposition of a tax with respect to sales of material to the contractor violated the Constitution of the United States because its incidence fell directly upon the federal government, and that the government's contracting officer had no authority to waive this constitutional immunity by providing in the contract for the reimbursement of state and local taxes paid by the contractor. Having disposed of the case in this manner, the court did not consider the question of territorial jurisdiction and the effect of the Buck Resolution.

The conclusion of the court on the constitutional question is, of course, consistent with the holdings of the Supreme Court in the *Panhandle Oil Co.* case (277 U. S. 218), *Graves* v. *Texas Co.* (298 U. S. 393), and similar cases. However, the tendency of the Supreme Court to re-examine the holdings of previous cases relating to intergovernmental tax immunities cannot be mistaken. Its holdings in the *O'Keefe* and *Gerhardt* cases have been hailed as indicating an important shift in constitutional doctrine and as heralding a general re-examination and restatement of the constitutional limitations upon the power of the States to impose taxes with respect to the activities of the United States and its instrumentalities. If I may hazard a guess as to the ultimate decision on the question whether post exchanges are federal instrumentalities, it is that the United States Supreme Court will hold that they are not.

In any event, if the *Query* and *King and Boozer* cases reach the Supreme Court, it will have an opportunity to lay at rest many of the doubts, uncertainties and conflicting opinions with respect to the nature and extent of the constitutional limitations upon the taxing power of the states and the effect of the provisions of the Buck Resolution thereon. Whether it will do so remains to be seen; in both the Alabama and the South Carolina cases, applications for certiorari to the Supreme Court have been filed.

I think I might in conclusion say that the Buck Act was to a very considerable extent conceived in doubt on the question of whether post exchanges were or were not federal instrumentalities. The bill was referred to the Committee on Finance, and if I can take just a moment I will read briefly from the report of that committee. They say, "Tangible personal property purchased from a commissary or a ship's store by an Army or Navy officer or other person so permitted to make purchases is exempt from the state sales tax or use tax, since the commissary or ship's store is an instrumentality of the United States. If voluntary unincorporated organizations of Army and Navy personnel such as post exchanges are held by the courts to be instrumentalities of the United States, the same rule would apply to similar purchases from such organizations, but if they are held not to be such instrumentalities, property so purchased would be subject to the state sales, use tax in the same manner and to the same extent as if such purchase was made outside the federal area. It may also be noted at this point that if a post exchange is not such an instrumentality, it will also be subject to the state income taxes by virtue of Section 2 of the Committee Amendment."

So I say, the act was to a certain extent one conceived in doubt, and hasn't yet grown old enough in years to have those doubts resolved.

CHAIRMAN GERSTENBERG: I have several announcements before we proceed. I will repeat that there is a meeting of the Executive Committee at 5:30 in Room 1100. Everybody is asked to register.

On the next announcement I am going to read the footnotes. Most of the speakers have not read the footnotes, but I am going to start with the footnotes. It says here, "At the first opportunity make this announcement, please. P. S.: Mr. Chairman, this is not hokum. See the pamphlet attached." Probably you can't see the pamphlet from where you are, but there are four gentlemen here with 3-inch collars. Two of them have bicycle-handle mustaches. The note reads, "The principal social function of the convention, gentlemen, is the reception in Room 436 at 5 p. m. sponsored by Joe Dunn of the Oklahoma Tax Commission, Mr. Pyle, and Mr. Cash, also of Oklahoma, representing the Society for the Preservation and Encouragement of Barber Shop Quartette Singing in America. If you have ever sung 'Sweet Adeline,' or wanted to sing it, you are invited. St. Paul's famous Barber Shop Quartette, the Hobnobbers, will give a recital."

Mr. John McConneloug, of the local reception committee, is a member of the society, and urges you to be present, Room 436, at 5 p. m. Thank you.

Now we will hurry through, so that you and I can go up and bend our elbows and sing "Sweet Adeline," but we have really a half-hour together ahead with the discussion of these four very interesting papers. If you have any questions, the speakers are still here.

SETH T. COLE (New York): I am sure that we are all very much interested, particularly those of us who belong to the legal fraternity, in the very fine papers that were presented by the four speakers this afternoon. From the remarks of some of the earlier speakers, I was reminded of a certain textbook on law that I read at one time which discussed a decision of the United States Supreme Court with which the author quite obviously was not in agreement. He concluded his discussion by saying, "Two Justices quite properly dissented."

What I want to say in discussion has to do not with past decisions but with possible future decisions. In other words, instead of looking through the telescope to the past, we will turn it around and try to get a glimpse of the future.

There is an important case on its way from New York to the United States Supreme Court which involves the authority of the decision of that court in Wachovia Bank and Trust Company against Doughton. You will recall that in that case a decedent domiciled in Rhode Island or Massachusetts—I have forgotten which—created a trust by will and gave the power of appointment, also by will, to a resident of North Carolina. The North Carolina resident died

and exercised the power, and North Carolina undertook to impose a death tax upon the appointed property. The Supreme Court held that the state had no jurisdiction to impose such a tax.

In the New York case the trust was created by a Massachusetts decedent. There were three trustees, one of whom resided in New York. This trustee was also a beneficiary of the income of the trust to the extent of one-third, and had a power of appointment by will over one-third of the trust property which he exercised upon his death while a resident of New York. The case has been decided by our Court of Appeals, which followed the Wachovia case. A petition for certiorari is now pending in the United States Supreme Court. The state is of the view that the decisions in *Curry* v. *McCanless* and *Graves* v. *Elliott* have indicated enough of a change of view on the part of the Supreme Court to invalidate the Wachovia decision.

It must be borne in mind that neither in the *Wachovia* case nor in this New York case was there involved a general power of appointment. In each case it was a power of appointment to be exercised by will only, and under the decisions of the New York courts, a contract to exercise a power of appointment by will is unenforceable, so that the question arises as to whether there was anything upon which the taxing power of the State of New York might operate so far as the exercise of this power of appointment was concerned.

It is a very interesting question. I take it it is a very close one, and probably when we come back to this National Tax Conference next year and reach this particular portion of the program, that will be one of the decisions that will be discussed.

Chairman Gerstenberg: Thank you, Mr. Cole.
Has anybody any other light to throw on possible questions?

William C. Warren (New York): I would like to just make one comment on what Mr. Cole had to say, simply because this case in New York which he commented on has been widely commented on in the law reports. I think there has been a great deal of misunderstanding in this case, for the reason that the *Curry* case involved a reserve power of the settlor, whereas in this case you have a true power of appointment.

I just wanted to get that in the record, because everyone has more or less assumed that the *Curry* case overruled the *Wachovia* case, whereas there is a distinction in the type of power.

Chairman Gerstenberg: Would anybody else like to argue this case?

Leffel Gentry (Arkansas): I would like to ask a question. I am looking for information, trying to learn. I would like to ask

this question of Mr. Dodd, if I may; I might ask the question by briefly stating our regulation that has been promulgated in our state with reference to the collection of sales tax on out-of-state sales.

We have recently, in view of the decision in the *McGoldrick* case, promulgated a regulation which requires out-of-state concerns to act as our collecting agent in collecting the sales tax on sales made by them and shipped by way of common carrier or trucker to the purchaser in our state where the seller maintains no business location in the state — that is any sales office, any warehouse, or any retail establishment, but where he maintains a force of anywhere from two to twenty-five traveling salesmen throughout the state. Some of those concerns are qualified to do business in the state in the sense that they are foreign corporations and are qualified. Some of them are not. But in the light of the *McGoldrick* decision this regulation attempts to require them to collect the tax as our tax-collecting agent.

I might explain that our statute is a sales tax or is a gross receipts tax upon which the tax is finally upon the privilege of the purchase for consumption. We do not have a use tax. I would like to know from Mr. Dodd his opinion as to whether or not we have any likelihood of having our regulation stand up.

CHAIRMAN GERSTENBERG: May I say before you answer that, although that question is asked by Arkansas, every state in the union down to Wyoming will be interested in it, I think, within a year, so we are all interested in it, Mr. Gentry. We will be glad to get that answer of Mr. Dodd.

MR. DODD: I am not sure that I should attempt to answer a question which is so serious, but in connection with the *Sears Roebuck* case, the court said that the duty imposed upon Sears Roebuck to collect a tax on sales made in Iowa purely by mail was occasioned by the fact that Sears Roebuck had stores in Iowa. But they say at the same time that the sale was in Iowa, it was for use in Iowa, and they have said that in the *McCanless* and other cases, that anything that can be reached by the tax-gatherer may be taxed, and it seems to me, and I think I indicated it in my paper, that the view of the *Sears Roebuck* case can readily be applied to sales made within the state.

Now, the case, the Realsilk Hosiery Company, isn't it, versus Portland?

CHAIRMAN GERSTENBERG: *Portland Cement* case is the one I have been trying to think of.

MR. DODD: No—this is not cement. This is the Realsilk Hosiery.

CHAIRMAN GERSTENBERG: What was that one in Massachusetts, Mr. Dodd? It originated in Massachusetts.

MR. DODD: I don't remember on this point.

MR. GENTRY: Cheney Brothers.

MR. DODD: But in the *Realsilk Hosiery* case, it was held that the state or the city could not tax the local solicitor who went from door to door to make sales which were filled then by means of the mail.

Under the *Sears Roebuck* case, it seems to me the court cannot draw a distinction between a sale entirely by mail, because of the fact that there is a store also operated by the same company. I don't see that the court can distinguish that situation from a situation in which, as in the *Realsilk Hosiery* case, they had people come into the state to make the sales.

I tried to indicate in my paper that it seemed to me that if Sears Roebuck & Company have stores in Iowa, as they had in that case, the state can require them to collect the tax, the case says, on the ground that it also has stores there, and is chartered to do business in that state.

It seems to me that if Montgomery Ward did not have stores there and was selling by mail or by solicitation from house to house, they could equally be required to make the collection, because the sale is in Iowa still, the use is in Iowa, and the court has based its decision largely upon those two facts.

MR. GENTRY: I might explain — it might be that you have the same problem in some of the other states. For example, one of the largest cities adjacent to Arkansas is the city of Memphis, which lies just east of the Mississippi River. It draws from a trade territory which is the very richest section in our state. A great deal of their business—in fact, we very often say that Memphis is made by Arkansas and Mississippi—is drawn from the two states of Arkansas and Mississippi, and some one thousand business concerns in the City of Memphis, Tennessee, operate in our state through the means of traveling salesmen, and they make delivery of their goods to our state. At this time we have pending litigation in which we are suing nearly all of them for the sales tax on sales that have been made in that way to purchasers in our state.

I would like to point out that in the *McGoldrick* decision, although the court pointed to the fact in the statement of the facts that there was a sales office maintained by the seller in the City of New York, that is merely pointed to in the statement of the case, and the court in its decision never gives any particular significance to the fact of this factual existence there of the sales office in the City of New York. At least, it is our construction that the decision was based upon the fact of the particular kind of tax, that is, it was not a tax upon the privilege of sale in the sense of an occupation tax upon a kind of business, but it was a tax upon the privilege of the purchase

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for consumption, and they finally said that the tax, if we understand the decision correctly, could be laid and collected after the goods reached the destination and after it had been in the course of interstate commerce, so long as the taxing statute was so framed as to lay the tax upon the privilege of the purchase for consumption. We would take it that way, but we are having some difficulty in convincing some taxpayers.

Mr. Rottschaefer: I hesitate to jump into this field after what Mr. Dodd has said, but I do think that there are really two problems there. The first problem is the power of your state to impose the tax at all. The second problem is its power to resort to a particular method for collecting that tax.

I think most of the discussion that you have given has concerned itself rather with the first of those two problems — their power to impose the tax. I wouldn't be a bit surprised at all if the court should hold that you have the power to impose the tax, unless they are going to back-track, because they, after all, if they adopt another theory, the state of origin may be held capable of imposing the tax, and then you would get that multiple burden.

Mr. Gentry: May I ask a question right there? Is there any fundamental reason why one seller who may maintain a cubby-hole office in my state and may have only one traveling salesman who hangs his hat there on Saturday when he comes into the office, should be subjected to collecting our sales tax, more than a concern which does not have that sales office but may have fifty traveling salesmen in my state?

Mr. Rottschaefer: I am coming to that. I will answer that when I take up the second point, the power of your state to resort to that particular method of collecting the liability, that we will assume now can be imposed.

The difference between those two situations it seems to me is just this: that a long time ago Mr. Justice Holmes in one of his opinions took the position that after all the only limit on the jurisdiction of the state to tax was its power to enforce the tax. You start from that as a premise, where you have a representative of the company doing business in the state. You see, they are present there. They may not be present for the purpose of certain questions of jurisdiction with respect, say, to the question of commencing suit by service of process upon them; but, after all, that corporation is present there through him, and you can reach him, but if he stays outside and sends nobody in there, where is that physical basis for power that Mr. Justice Holmes has so often stressed in connection with tax problems?

Mr. Gentry: Might I ask one other question along that line?

CHAIRMAN GERSTENBERG: May I interrupt a moment to say that really aren't you asking him where he bought those thousand suits?

MR. GENTRY: Yes, sir, I was fixing to ask a question which would explain that.

MR. ROTTSCHAEFER: I didn't know he bought them.

MR. GENTRY: Under our statute, we have a process of arbitrarily assessing the tax, and by giving notice that we have done so, and we have fixed the tax at a high enough figure, not having access to their records, so as to get the jurisdictional amount in federal court, and we have gone over to Memphis in federal court and sued them.

MR. ROTTSCHAEFER: I would say this: that the only basis for that physical power in the case of enforcing it against them, where they don't send salesmen in but just send a catalog, would be the presence within the state prior to the transfer of title to the ultimate consumer, of that physical object that you are selling. So that you could probably start suit by a sort of proceeding *quasi in rem.* That may give you the physical basis. I am arguing on the basis of Justice Holmes' emphasis on the basis of which I think you can distinguish the two, the situation of the Sears Roebuck people and some other people that just send catalogs.

MR. GENTRY: I might further explain that we have the permit system, by which all sellers must have a permit. A penal provision is provided, and we take the position that the salesmen themselves, as agents for the seller, are subject to the criminal provisions of the act.

MR. DODD: Mr. Chairman, I would like to make just one remark, and that is that I think your standard is that set by Mr. Justice Stone, now Mr. Chief Justice Stone. He said that the state could come to tax anything that came within the grasp of the tax-gatherer. If you can collect it, it is all right.

CHAIRMAN GERSTENBERG: Are there any other questions? Is there any other discussion?

We are very much indebted to you for your very careful attention this afternoon. I am sure that everybody has had a very good time and a very profitable time.

(The session thereupon adjourned, at four forty-five o'clock.)

FIFTH SESSION

MONDAY, OCTOBER 13, 7:45 P. M.

Ballroom, Lowry Hotel

Royal B. Cushing, presiding.

CHAIRMAN CUSHING: While there are not many who have arrived for the evening session yet, I believe in starting proceedings reasonably promptly. The program will be long, so it will be late enough if we start right now.

I like the looks of this audience, but they are so far away that I can hardly see them. I sat way back there this afternoon, and found it rather hard to listen. The front seats are no more expensive than the rear ones, and I am sure you will get a great deal more out of the evening session if you will come forward.

I want to have a good time here tonight, and so do all of you. To do that, I think we want pretty general participation, and so we are going to follow the rules of the conference very strictly. These papers are to be twenty minutes long. I don't want the speakers to hurry in order to finish in twenty minutes, because that spoils the rendition of the talk, as I have observed here today. Instead, you know that at the end of the twenty minutes anyone can move to extend the time, so that the paper can be finished in due course. In other words, I want everyone to participate in this program.

I remember when I was in law school we had a professor who was very diligent, who had wonderful discourses and papers, but one of my classmates said, "Are you going over to hear Professor Cascarets today?"

"What do you mean?" I said. "Oh, I get you. He works while you sleep." Let everyone be on his toes and ready to participate in the general discussion.

This subject doesn't sound very thrilling to us, "Taxation of Governmental Securities and the Income Therefrom." I remember a paper that was given at the Atlanta Tax Conference in 1917 on war finance by our dear Professor Bullock, who was made president of the Association at that session. I am just going to read an extract from that paper while they are gathering here. It is intended to take away, perhaps, some of the thunder of the people who are going to speak, which isn't quite fair.

Professor Bullock in 1917 said, "It would have been fortunate last spring if our government had seen its way clear to issue bonds subject to taxation, enjoying no exemption of any description whatsoever, had it then been willing to go into the market and pay the current rate of interest. It would actually have meant money in the

treasury in the long run, and it would also have avoided the unfortunate result of creating in the community a class of people who in accordance with the terms of their contract made with the government are exempted from ordinary taxation. Just at present this difficulty does not impress us as very important. It seems more important to get the bonds sold and it seems not to matter so much how they are marketed. But after the war if any politician seeking to array one class against another class points out that there are in the community millionaire bondholders who are exempt from the income tax, you want to remember that Uncle Samuel is responsible, and the millionaire bondholders are not to blame. They merely took the government at its own terms."

I thought that was a very good introduction to the evening program tonight.

The first speaker listed on the program is Edward H. Foley, Jr., general counsel of the United States Treasury. It became impossible for him to attend, and his assistant, Charles L. Kades, assistant general counsel of the United States Treasury, knowing this a few days ago, prepared the paper and will present the paper.

Mr. Kades.

Charles L. Kades: Mr. Chairman, Ladies and Gentlemen: I was very much interested in the quotation which the Chairman read from Professor Bullock's paper, because, as you all know, the Treasury has now eliminated tax-exempt issues in so far as the federal government is concerned, and all securities issued after March 1, 1940, on behalf of the United States, are now subject to full federal income and sur-taxation, as well as state, estate, and other excise taxes.

My own subject is the taxation of the income of those governmental securities which are now not subject to taxation and which have not yet been issued, namely, securities hereafter issued by states and municipalities.

TAXATION OF THE INCOME FROM GOVERNMENTAL SECURITIES

CHARLES L. KADES

Assistant General Counsel for the Treasury Department

During January of this year, my friend Solicitor General Epstein declared in a public address that the retention of tax-exempt securities is necessary for "the very continuance of the Federal structure of our government", and that the issue involved in the attempt to eliminate them marked "the constitutional crossroads of state and local government in America." [1]

[1] Henry Epstein, Solicitor General of New York in an address delivered before the Committee on Municipal Law of the New York State Bar Association, January 24, 1941, in New York City.

This bit of extravagant oratory illustrates the need for a less hysterical and a more rational examination of the tax-exempt securities problem.

It is important to discuss this problem with some sense of responsibility and without distortion because the existence of tax-exempt securities raises a cardinal issue in our fiscal system.

At bottom it is not a question of state sovereignty or of any other political abstraction; it is a very practical problem of equity in taxation.

I

The somewhat cynical mood which followed World War I was due in no inconsiderable part to the belief that the manpower of the country had been subject to the draft while the wealth of the country had escaped taxation through loopholes in the national tax system.

This is the kind of sentiment which undermines national unity, and this in turn undermines national defense, for taxation is an essential part of defense. The nation needs, as Secretary of the Treasury Morgenthau has said, "all out" taxation to support "all out" defense.[2]

The defense program must be paid for, sooner or later, by the taxpayers of the United States. To the extent that the national government issues bonds, the taxpayer's burden is postponed.

Ultimately, however, the principal of and interest on those bonds will be paid from money raised by national taxation. And if any class of citizens is then beyond the reach of the national taxing power, other citizens will have to assume the burden of providing the money necessary to pay those bonds.

The people of this country are ready and willing to bear the burdens of national defense. These burdens ought to be distributed equitably. In order to achieve this objective, however, the tax program must keep pace with the rest of our defense program.

All would agree with the principle that no one should ask or receive any immunity from fulfilling the obligations of good citizenship. It is unwise to continue to give this principle only lipservice.

In the words of President Roosevelt, "defense is a national task to which every American must contribute in accordance with his talents and treasure." [3]

Although we talk of financial sacrifices by all, we still tolerate a class of Tax Untouchables. Merely by purchasing state and municipal bonds any taxpayer can avoid paying not only normal income

[2] *Hearings before the Committee on Finance, United States Senate, on the Revenue Act of 1941*, 77th Cong., 1st Sess. (1941) 2.

[3] Letter to Chairman Doughton, *Hearings before Ways and Means Committee, House of Representatives, on the Revenue Act of 1941*, 77th Cong., 1st Sess. (1941) 477.

taxes but can also nullify the heavy new surtaxes levied to help pay for the defense program.

Mr. Justice Holmes once said, "Taxes are what we pay for civilized society." No individual should be able to have the benefits of civilization at a discount. But many do.

Take, for example, the case of Mr. D, who is a resident of the State of New York. Mr. D is married, has no dependents, and will have a total net income of $100,000 during this year. His salary is $10,000 a year and he will also receive interest in the amount of $90,000 from bonds of the City of New York.

If this interest were subject to federal and New York state income taxes, Mr. D would pay income taxes in the amount of $54,824. Actually he will pay only $1,524. In other words, Mr. D will pay federal and state income taxes to a grand total of 1½ percent of his net income.

Thus, Mr. D with a $100,000 income actually pays at the same effective rate of income tax as a married individual having a net income of approximately $1,850.

The New York City bonds which Mr. D owns bear interest at the rate of 3 percent. But for Mr. D to have as much net income left after taxes, if he invested his capital in private corporate bonds, would mean that he would have to find bonds yielding almost 9½ percent.

It is apparent from this example, which might be multiplied by many others, that the income tax can not fix with equity the tax liability of individuals and corporations as long as the Treasury is required to allow taxpayers to exclude from their gross income the interest on state and municipal bonds.

No express provision of the constitution imposes this requirement upon the Treasury. Thomas Reed Powell used to say that sometimes the constitution spoke with such a still, small voice that only a majority of the judges could hear its echo. But on this subject of tax immunity the constitution is as silent as a dream.

Congress, however, has spoken by specifically providing that there "shall not be included in gross income" the interest upon "the obligations of a State, Territory, or any political subdivision thereof" and that such interest "shall be exempt from taxation." [4]

[4] Sec. 22(b)(4), I.R.C., 53 Stat., Part I, p. 10. The Revenue Acts since 1913 have contained this exemption. *Cf.* section II(B) of the Act of October 3, 1913 (38 Stat. 114, 166-181); section 4 of the Revenue Act of 1916 (39 Stat. 756, 758); section 213(b)(4) of the Revenue Act of 1918 (40 Stat. 1057, 1065), Revenue Act of 1921 (42 Stat. 227, 238), Revenue Act of 1924 (43 Stat. 253, 268), and Revenue Act of 1926 (44 Stat. 9, 24); section 22(b)(4) of the Revenue Act of 1928 (45 Stat. 791, 798), Revenue Act of 1932 (47 Stat. 169, 178), Revenue Act of 1934 (48 Stat. 680, 687), Revenue Act of 1936 (49 Stat. 1648, 1657), and Revenue Act of 1938 (52 Stat. 447, 458).

In the absence of this statutory exemption, all citizens of the United States would have to include in gross income the interest derived from state and municipal bonds, in the same way as they now include all income derived from any other source.

If the principle of progressive income taxation is equitable, the issuance of tax-exempt securities is inequitable because taxpayers can flatten out the progressive curve of the graduated income tax simply by investing in state and municipal bonds. For this reason every administration since the enactment of the progressive income tax, Republican as well as Democratic, from President Wilson to President Roosevelt, has advocated the elimination of tax-exempt securities.

How can we justify to the American people the issuance of public securities which furnish, to those who can afford to buy them, a well-beaten path of escape from increasingly steep tax rates?

II

Clever demagogues to the contrary notwithstanding, we are not concerned in this discussion with the question of national taxation of state or local property. We are not concerned with national taxation of the income of state instrumentalities. Nor are we concerned with any kind of property or *ad valorem* taxation of state or municipal bonds.

The sole issue before us is this: Does the constitution exempt the income of an individual or a private corporation from taxation by the national government, simply because it is derived from a state or municipal bond? In other words, is a constitutional amendment necessary to end tax-exemption privileges of private persons?

In considering this question, it is important to recognize that the United States is not only a government, but a national government. The national government can not, of course, govern the states, but it is the government of all the people of the United States. When Congress acts, it operates directly upon individuals and private corporations. And it operates just as directly upon them as does the legislature of any state.[5]

No state and no city stands between the Congress and the people. For the national government is the organ of all the people of the United States in everything it is empowered to undertake.

Those who purport to oppose the elimination of tax-exempt securities upon the ground of "states' rights" overlook the fact that a major objective of calling the convention for the revision of the articles of confederation was to give the national government its own sources of tax revenue independent of the states.[6]

[5] *Constitutional Government in the United States*, by Woodrow Wilson, New York, Columbia University Press (1908), pp. 182-85.

[6] Even the feeble articles of confederation intended to grant to the Congress an unlimited power to provide for the pecuniary needs of the general

It was obvious to all the delegates to the constitutional convention who sought to write a constitution adequate to the needs of government, and even to those who only wished to amend the articles of confederation, that the one absolutely necessary power for the national government was the power to raise money by means of taxes imposed directly upon individuals.[7]

The first of eighteen specific powers which the committee on detail recommended be granted to Congress was this power to collect taxes from all citizens of the new nation; and the convention voted unanimously to grant Congress this power of general taxation.[8]

When the states formed a more perfect union under the constitution, they lost the power to levy imposts or duties affecting imports and exports and on tonnage, unless they first obtained the consent of Congress.[9] In other respects, the taxing power of the states had the same scope as before the constitution was established.

On the other hand, the organic law now gave to Congress the great power [10] to lay and collect taxes in order "to pay the Debts and provide for the common Defence and general Welfare of the United States." [11]

No express limitation was inserted in the constitution on the power of either the national government or a state government to tax the property or the income of the instrumentalities of the other.

government. Under the articles, Congress was authorized to borrow money and to ascertain the sums of money necessary, in its judgment for the services of the United States. The requisitions of Congress for such sums, if in accordance with the rule of apportionment, were obligatory upon the states. Articles VIII and IX of the articles of confederation (1777). But by 1786, further borrowing became impossible because requisitions upon the states yielded almost nothing. "Requisitions are a perfect nullity," Washington wrote to John Jay in August of that year. *The Writings of George Washington*, by Jared Sparks, Vol. IX, p. 188.

[7] *The Making of the Constitution*, by Charles Warren, Boston, Little, Brown & Co. (1937), pp. 465, 466.

[8] Proceedings of the Convention, August 6, 1787. *Journal, Acts and Proceedings of The Convention*, Boston, Thomas B. Wait (1819), p. 220.

[9] *U. S. Const.* Art. I, sec. 10.

[10] Hamilton summarized this power as follows:

> "The National Legislature has express authority 'to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defence and general welfare,' with no other qualifications than that 'all duties, imposts, and excises shall be uniform throughout the United States; and that no capitation or other direct tax shall be laid, unless in proportion to numbers ascertained by a census or enumeration, taken on the principle prescribed in the Constitution,' and that 'no tax or duty shall be laid on articles exported from any State.' These three qualifications excepted, the power to raise money is plenary and indefinite." *The Works of Alexander Hamilton*, edited by Henry Cabot Lodge, New York, G. P. Putnams Sons, 1885, Vol. III, p. 371.

[11] *U. S. Const.* Art. I, sec. 8.

But in the great case of *McCulloch* v *Maryland*[12] the Supreme Court recognized the existence of an implied limitation in holding invalid a state tax laid specifically upon the privilege of issuing bank notes, and in fact applicable alone to the notes of the Bank of the United States.

The underlying reason for implying this immunity from taxation was to insure the freedom of the national government in its choice of alternatives. This implied immunity was also deemed to protect the continued existence of the states as governmental entities.

Because the states as well as the national government may exercise the power of taxation over persons within the same territory, it has been essential to their mutual preservation that neither be allowed to cripple the operations of the other through the use of this power.

But to extent this rule to exempt an individual from a personal tax not only under modern conditions loses sight of the original purpose of the immunity; it actually has the opposite result from that intended because it restricts government in its choice of a tax system and may seriously menace the entire fiscal structure.

As a matter of fact, a wealthy owner of state or municipal bonds not only gains a tax benefit at the expense of the national government, but he does not pass on a corresponding benefit to state or local government.

The supply of state and municipal bonds is so vast, amounting at the present time to nearly $20,000,000,000 in aggregate principal amount,[13] that these securities must bear interest rates high enough to attract buyers from corporations, insurance companies, sinking and pension funds, and other institutional investors, none of whom are subject to the high personal surtaxes.

Moreover, the market value to states and municipalities of the privilege of granting this subsidy to federal taxpayers is very dubious. There is appended to copies of my paper a table, which compares the yields of fully taxable high-grade corporate bonds with those of fully tax-exempt high-grade municipal bonds annually since 1900.

It can readily be seen that the spread between private corporate and municipal bond yields is very erratic, and that on occasion the yields of the municipal bonds have been higher than those of the private corporate bonds.

It is also noteworthy that the *maximum* spread in favor of the municipals occurred *before* the introduction of the federal income tax. In fact, there does not seem to be any definite relationship between the spread and the maximum rate of this tax.

[12] (U. S. 1819) 4 Wheat. 316.

[13] *Report of the Secretary of the Treasury for fiscal year 1940* (1941), pp. 812-13.

It is fair to conclude (1) that the so-called spread is subject to a wide margin of error of estimate, (2) that the value attached by the market to the tax-exemption privilege fluctuates greatly from time to time, and (3) that tax-exemption has never been the decisive factor in determining municipal bond yields.[14]

It is upon such shifting statistical sands that the claim is based that the elimination of tax-exempt securities would impose a direct, substantial, and tangible burden upon the borrowing power of a state.

All taxation of property or income to some extent tends to raise the price level of labor, materials, or money, and thereby to increase the costs of government. But this is the normal incident of the organization within the same territory of two governments, each possessing the taxing power.

And the mere fact that the expenses of a state or municipality would be less if those who dealt with it were exempt from taxation is not considered by the Supreme Court to be an adequate basis for immunity from federal income tax.[15]

As you all know, the Supreme Court has definitely rejected the claim that the doctrine of reciprocal immunity prohibits the application of the income tax to the salaries of the officers and employees of states and their instrumentalities. Speaking for the court, Mr. Justice (now Chief Justice) Stone pointed out that "the purpose of the immunity was not to confer benefits on the employees by relieving them from contributing their share of the financial support of the other government, whose benefits they enjoy, or to give an advantage to that government by enabling it to engage employees at salaries lower than those paid for like services by other employers, public or private, but to prevent undue interference with the one government by imposing on it the tax burdens of the other."[16]

An investor who clips coupons from state or municipal bonds is surely no more an instrumentality of state or municipal government than a person who earns his livelihood by working for a state or municipality. Judged by any practical criterion, those who buy state and municipal bonds do not perform a function in state or municipal government which entitles them to claim an immunity granted to the state or municipality itself.

[14] Observations of the market differentials, made before the cessation of further issuance of tax-exempt securities was generally considered a strong probability, fairly represent the differentials at which substantial amounts of *new* borrowing through the issuance of tax-exempt securities could be accomplished. Present measurements of the differential reflect in large part an expected scarcity value for the outstanding supply of tax-exempt securities, and hence do not indicate the additional interest cost if tax-exempt securities were eliminated.

[15] *James* v *Dravo Contracting Co.,* (1937) 302 U. S. 134; *Helvering* v *Mountain Producers Corp.,* (1938) 303 U. S. 376.

[16] *Graves* v *O'Keefe,* (1939) 306 U. S. 466, 483-84; *Helvering* v *Gerhardt,* (1938) 304 U. S. 405, 421-22.

The doctrine of *McCulloch* v *Maryland* was not intended to give an advantage to state and municipal governments by enabling them to issue bonds at interest rates lower than those paid by other borrowers. Nor was it intended to confer benefits on the bondholders of one government, national or state, beyond benefits granted even to officers of that government, by relieving the bondholders of the common duty of citizenship of contributing their share to the support of the other government.

III

No modern revenue system can ignore the development of a sound personal tax based on the principle of ability to pay. The government protects the citizen's person from injury, fosters his health, promotes his education, underwrites his security, and provides the environment in which he can produce and acquire those goods and services important to his welfare. What can be more appropriate than for the government to require of this citizen a personal tax measured by his income from whatever source derived.

The federal income tax is intended to be such a tax. Regardless of its phrasing it taxes the individual or the corporation on an amount which is measured by net income.

The income may be derived from many sources. The compensation which the individual receives for his personal services, his rewards as a merchant, the return for the use of his capital, are all accumulated in a mass of income from occupations and investments. It is the receipt of this bundle of income by the individual, and not the source of the income, which is the essential element.

Nor is income, as such, the sole basis of the tax. The tax takes into account the number and the age of the taxpayer's dependents, his income from other sources, his donations to philanthropies, and many other factors. All of these are matters which relate primarily to the taxpayer's person. This is apparent enough when one considers that A pays a tax and B does not and C pays more than D, although A, B, C, and D may all have identical amounts of income.

When the federal income tax, therefore, is applied to interest received by a state or municipal bondholder, it is neither in form nor in substance, in terms nor in effect, a tax upon the state or the municipality which issued the bonds. The tax is levied only upon the taxpayer who receives the interest from the bonds as his private property. It is not in any sense a tax imposed upon the property or the income of the state or municipality which pays the interest. It is not even a tax upon the obligation to pay the interest. Even if the interest were subject to federal income tax, a person might own a large quantity of state and municipal bonds and nevertheless pay no tax whatever.

I know that this view of the nature of the federal income tax conflicts with the analysis made by the Supreme Court in *Pollock* v

Farmers Loan and Trust Co.[17] But the social and economic incidences of progressive income taxation are more clearly understood today than they were in the mental climate of the 1890's. You will recall it was in this same case that Joseph Choate could seriously denounce the income tax to the court as "communistic in its tendencies."

A few years ago Mr. Justice Cardozo declared that the decisions of the Supreme Court "forbid us to stigmatize as unreasonable the classification of a tax upon net income as something different from a property tax, if not substantially an excise."[18]

And today, it is well established that the income tax is levied only upon the person receiving the income for "the privilege of receiving it", and that "the theory, which once won a qualified approval, that a tax on income is legally or constitutionally a tax on its source, is no longer tenable."[19]

Since the 1890's a personal tax measured by net income has developed as a highly important element in the tax system of every great nation. Other countries with federal systems of government, such as Canada and Australia, have completely rejected the application of the doctrine of inter-governmental tax immunity to government bondholders, as well as officeholders, without noticeably impairing their federal systems.[20]

In the United States, even before the sixteenth amendment was adopted, the Supreme Court had upheld a federal corporation excise tax which was measured by net income from whatever source derived, including interest from state and municipal bonds.[21] The court has also upheld state corporation excise taxes which are measured by net income, including interest from federal obligations, even though Congress has specifically exempted such interest from state taxation.[22] Only last year the court, in upholding a state tax on national banks, reiterated "the rule that a tax upon a legitimate subject, measured by net income, including that from tax-immune federal instrumentalities, is not an infringement of the immunity."[23]

No amount of hair-splitting can obscure these two facts: (1) that Congress possesses and has heretofore exercised the power to tax a base which included the income from state and municipal bonds, and (2) that state legislatures possess and are now exercising the power to tax a base which includes the income from federal bonds.

[17] (1895) 157 U. S. 429; 158 U. S. 601.

[18] *Hale* v *State Board,* (1937) 302 U. S. 95, 106.

[19] *Graves* v *O'Keefe, supra,* note 16 at p. 480, per Stone, J.

[20] See, for example, *Caron* v *The King,* (1924) A. C. 999, *Davoren* v *Commonwealth Commissioner of Taxation,* (1923) 32 C. L. R. 616.

[21] *Flint* v *Stone Tracy Co.,* (1911) 220 U. S. 107.

[22] *Educational Films Corp.* v *Ward,* (1931) 282 U. S. 379; *Pacific Co.* v *Johnson,* (1932) 285 U. S. 480.

[23] *Tradesmen's National Bank* v *Oklahoma Tax Commission,* (1940) 309 U. S. 560, 565.

In every case, this has been achieved by the simple expedient of phrasing the taxing statute in terms of an excise or privilege tax. Surely, the fact that such a great constitutional distinction can be made to turn upon such a trivial verbal difference indicates a distinct lack of fundamental reason and reality in the doctrine of the *Pollock* case.

The judicial authority of the *Pollock* case depends entirely upon the reasoning by which it has been supported. Since the opinion in the *Pollock* case was based upon a misconception of the nature of an income tax, it is the law of the Supreme Court that the decision is open to reconsideration.[24]

Persons receiving interest from state and municipal bonds enjoy the same benefits of government as do the recipients of other income. The income tax is gauged in part according to these benefits and in part according to the stake which each individual has in the economic order. To tax this interest along with other incomes merely establishes equality of treatment.

A sound personal tax is the symbol of democracy. It represents the returns which every person who enjoys (above a specified minimum) the fruits of a community organized on his behalf must pay. A personal tax is also a safeguard of democracy since it is a means by which an excessive concentration of wealth and power can be avoided. Any personal tax which leaves out of its measure a large segment of the flow of wealth is defective and unjust.

It is hard to believe that at a time when we are mustering all our strength for the task that lies ahead, the fight against tax-exempt securities has not yet been won.

Other progressive measures, such as the direct election of United States senators and equal suffrage for women, were at one time denounced as violating the doctrine of states' rights.[25] In fact, a former Ambassador of the United States, Richard Washburn Child, included federal aid for maternity and child hygiene among the reforms which he said were making the federal government "a top-heavy agency of tyranny to make all individuals goose-step alike." [26]

The enactment of child labor legislation was also bitterly opposed by Governor Ritchie of Maryland as an attempt "to strike down state responsibility" and "to nationalize and standardize the control

[24] *Passenger Cases*, (U. S. 1849) 7 How. 283, 470, per Taney, J. Compare Frankfurter, J. in *Graves* v *O'Keefe*, *supra*, note 16 at pp. 491-92: "The judicial history of this doctrine of immunity is a striking illustration of an occasional tendency to encrust unwarranted interpretations upon the Constitution and thereafter to consider merely what has been judicially said about the Constitution . . . But the ultimate touchstone of constitutionality is the Constitution itself and not what we have said about it."

[25] For example, see (1919) 59 Cong. Rec., pp. 561-562; (1911) 47 Cong. Rec., pp. 1923-1924, 2122, 2380, 2404, 2453, 2695.

[26] Richard Washburn Child, *The Doctrine of Local Obligations* (1929), Sen. Doc. No. 110, 71st Cong., 2d Sess.

of the child." [27] During the debate on the child labor bill of 1907 a Southern jurist wrote to Senator Beveridge that "one of the most grotesque spectacles ever presented to the American public is the frantic and clamorous defense, now being made on all hands by the railroad corporations, of the doctrine of 'states' rights'." [28]

Once more the strategy of those who seek to block a progressive measure is to reach out their hands and clutch at the straw of "states' rights". There is nothing new in the arguments of those who now urge the perpetuation of this tax-exemption privilege. Their arguments have been the stalking horses of special privilege whenever government has tried to remove a social injustice. Vested interests have always been glib in using "states' rights" as a foil against heavy taxation and inconvenient regulation.

The progressive legislators of a generation ago did not let themselves be led astray by such arguments. It is for us to hold fast, as they did, to the democratic course. I am confident that when the next tax bill has been enacted into law, Congress will have once more placed itself on the side of fairness and justice in taxation and will have ended this flagrant example of tax immunity for a favored few.

COMPARISON OF THE SPREAD IN YIELD BETWEEN CORPORATE AND MUNICIPAL BONDS WITH THE FEDERAL INDIVIDUAL INCOME TAX, 1900-41

(Yields are Annual Averages)

Year	High-grade corporate bonds [1]	Municipal bonds [2]	Spread	Maximum Federal individual income tax
1900	4.05	3.12	0.93	0
1901	3.90	3.13	.77	0
1902	3.86	3.20	.66	0
1903	4.07	3.38	.69	0
1904	4.03	3.45	.58	0
1905	3.89	3.40	.49	0
1906	3.99	3.57	.42	0
1907	4.27	3.86	.41	0
1908	4.22	3.93	.29	0
1909	4.06	3.78	.28	0
1910	4.16	3.97	.19	0
1911	4.17	3.98	.19	0

[27] Albert C. Ritchie, "State Responsibility" (1925), 11 *Am. Bar Ass'n. Journ.*, pp. 447, 448, 449.

[28] Letter from Judge A. H. Whitefield to Senator Albert J. Beveridge, dated April 29, 1907, quoted in *Beveridge and the Progressive Era*, by Claude G. Bowers, p. 255.

Year	High-grade corporate bonds [1]	Municipal bonds [2]	Spread	Maximum Federal individual income tax
1912	4.21	4.02	.19	0
1913	4.42	4.22	.20	7
1914	4.46	4.12	.34	7
1915	4.64	4.16	.48	7
1916	4.49	3.94	.55	15
1917	4.79	4.20	.50	67
1918	5.20	4.50	.70	77
1919	5.29	4.46	.83	73
1920	5.79	4.98	.81	73
1921	5.57	5.09	.48	73
1922	4.85	4.23	.62	58
1923	4.98	4.25	.73	58
1924	4.78	4.20	.58	46
1925	4.67	4.09	.58	25
1926	4.51	4.08	.43	25
1927	4.31	3.98	.33	25
1928	4.34	4.05	.29	25
1929	4.60	4.27	.33	24
1930	4.55 [3]	4.07	.48 [3]	25
1931	4.58	4.01	.57	25
1932	5.01	4.65	.36	63
1933	4.49	4.71	—.22	63
1934	4.00	4.03	—.03	63
1935	3.60	3.41	.19	63
1936	3.24	3.07	.17	79
1937	3.26	3.10	.16	79
1938	3.19	2.91	.28	79
1939	3.01	2.76	.25	79
1940	2.84	2.50	.34	81
1941 [4]	2.75	1.99	.76	81

Office of the Secretary of the Treasury, Division of Research and Statistics.

[1] Yields from 1900 through 1929 are those reported by Standard Statistics Co. for 15 high-grade railroad bonds. Yields from 1930 through 1940 are those reported by Moody's Investors Service for high-grade corporate (Aaa) bonds.

[2] Yields are as reported by Standard Statistics Co.

[3] Standard Statistics Co. index of yields of high-grade railroad bonds was 4.39 percent for 1930, and the spread based upon this index, 0.32 percent.

[4] September 24, 1941.

CHAIRMAN CUSHING: Thank you, Mr. Kades, for a very able paper.

It is rather interesting, isn't it, how truly the quotation I read from Professor Bullock criticizing the government of that day for tax-exempt federal securities and his prediction of that day has worked out, but now that is all remedied. Professor Bullock would be satisfied with the taxation of the federal securities as they are now being issued by our federal government.

I think we are ready for the next speaker to whom Mr. Kades referred in his paper, and I hope Mr. Epstein will return shot for shot, and we will call him to the platform.

Mr. Henry Epstein, Solicitor General, New York State. Mr. Epstein.

HENRY EPSTEIN: Mr. Chairman, Ladies and Gentlemen: By way of introduction I might in the first place state that the fictitious Mr. D. referred to by Mr. Kades just doesn't exist. The testimony and the facts revealed before the Senate and House committee which heard evidence on this very issue, and the figures taken from a survey of the Treasury Department's own records, show that for the last ten years or more the average amount of money in tax-exempt securities in the estates of over a million dollars of people who died in the United States was just slightly over 5 percent. So there aren't any people who are earning $10,000 and getting $90,000, or $80,000, or $70,000 from the tax-exempt bonds.

The constant recurrence of this issue is very reminiscent of an old story of what happened once in the Russo-Japanese War. After the battle, there were quite a number of Russians who were dead, and a doctor went around the field making a rather cursory examination, and those that were pronounced dead were cast up on a big bullock cart and were being hauled away to a burial trench a couple of miles away, and one of these bullock carts was being driven by Ivan Ivanovitch, and after he had progressed about half a mile, one of these so-called corpses came to life, and he recognized Ivan and said, "Ivan Ivanovitch, where are we going?"

When Ivan retorted, "To the burial trench," the corpse protested, "I am not dead. Why do you take me to the burial trench?" He got no response, and pretty soon, having been seriously wounded, he lapsed into unconsciousness. About half a mile further on the bouncing of the cart awakened him again, and again he proclaimed to Ivan that he wasn't dead, saying, "For heaven's sake, what I need is to go to a hospital. Don't take me to a burial trench."

Well, three or four times this happened, and pretty soon simple-minded Ivan was fed up, and he took his pistol from his holster and turned around, and, bang! — he shot the fellow. He said, "The doctor knows better."

Not only has the Supreme Court repeatedly pronounced that the issue of the burdening of state and municipal governments by a tax upon their borrowing power—and that is what it is, this issue, an invalid interference with what under our federal system is a real sovereignty that should be preserved, — but the Congress of the United States has repeatedly refused to enact into law that which has been advocated here by the preceding speaker, and which the Treasury Department is again seeking to have enacted into law.

It has been repudiated by the courts, it has been repudiated by Congress, it has been consistently opposed by the forty-eight states and the thousands of municipalities in this country as economically unsound as well as legally unsound, and yet the Treasury Department, knowing that it can't be a method of procuring ready revenue, uses all the rhetorical expression and so-called extravagant oratory in order to lead you to believe and lead the people to believe that this is a very great democratic method of equalizing taxation, and that it is something that we should support in our all-out for defense issues.

I propose to explode that in the course of these remarks, and I trust I shall be allowed a little over the twenty minutes.

THE OPPOSITION OF THE CITIES AND STATES TO FEDERAL TAXATION OF THEIR SECURITIES

HON. HENRY EPSTEIN
Solicitor General of the State of New York

We are shortly to be faced with a renewed attack on the independence of state and municipal financing, this time under the pretext of defense taxation. My thesis here today is that federal taxation of state and local securities would be destructive of our political institutions, unconstitutional and unsound economically: That any renewal at this time of the federal campaign to tax our local bonds would be far from a contribution to national unity and would on the contrary hamper and impede the national defense effort: That that unity of effort which is so essential to our national defense must not be seized upon as an opportunity for centralization of all sovereign powers in the federal government: That the surrender of local self-government is not the road of free states, and free cities and free people on their march to the defense of their democratic way of life.

The *United States Municipal News* has recently noted[1] that the last heroic defenders and remaining authority of orderly life in each of the conquered nations of Europe after the central government had been forced to move elsewhere were usually the mayors and munici-

[1] Issue of September 1, 1941.

pal authorities. That was true in Belgium where the Burgomaster of Brussels was the last to surrender, and it was true in Warsaw where the municipal authorities fought off the Nazis after everything else in Poland had crumbled. It was true in Jugoslavia, where even after the provincial governors had surrendered their authority, the municipal authorities continued the independent life as well as defense of their cities. All this is not surprising to those of us who pledge our faith in democracy and local self-government. The *Municipal News* points out that this was as it was in ancient days when the cities of Greece fought for their freedom and liberty and they recall the words of de Tocqueville who said:

> "Municipal institutions constitute the strength of free nations. A nation may establish a system of free government, but without municipal institutions it cannot have the spirit of liberty."

It is in this spirit that the states and cities have always opposed and, within the past three or four years, have fought with all of their united and determined strength to prevent their powers of local financing from being brought under the control of the central government.

The consequences of the establishment of a federal power to tax state and municipal bonds are not to be found in the cold numerology of abstract economics. Nor can we find any but a superficial answer in the mere comparison of estimated tax returns, on the one hand, with increased interest costs on the other. Those considerations, always so prominent, and which are expounded at great length in every discussion of this subject, are but the froth on the real issue, and that real issue is democratic self-government itself. This was clearly seen by a former President of the National Tax Association, the Professor of Economics at Yale, Fred Rogers Fairchild, who said: [2]

> "I think it can fairly be said that most proposals for coordination of the Federal and State income taxes spring from the desire for more centralization of power in the Federal Government. The states are today, I believe, threatened with a serious attack upon their sovereign existence. There are those who would like to see them reduced to small administrative departments as was done with the constituent states of Germany after the accession to power of Hitler. The easiest way to bring this about is by impairing the financial powers of the states. Without independent authority to raise a revenue and control its finances, no sovereign power can exist. My own opinion is that loss of their sovereign position by our American states would be a disaster of the first magnitude."

[2] *Annals of the American Academy of Political and Social Science*, March, 1941.

With greater unanimity than I have ever seen them manifest on any other issue, the states and cities of this country heartily endorse Professor Fairchild's analysis. The proposal to tax our state and city bonds is not really advanced for purposes of raising revenue. The Treasury representatives themselves have repeatedly been forced to admit that it can find little justification on that ground. Nor is there much substance to the appeal that the federal government must be given this tremendous power in order that it may shut off a channel of tax avoidance. The report which the senate supported in defeating this measure last year pointed out, on the contrary, that its effect would inevitably be regressive and that it would simply shift a further and unsupportable burden on the home owner and the rent payer. And I will presently deal with the utterly cynical attempt to cloak this proposal in the flag of national defense. Professor Fairchild has gone straight to the real truth and the real motives in this whole issue. It springs wholly from the misguided and dangerous political objective of establishing a complete centralization of power in the federal government.

I have referred to the threatened revival of this proposal on the excuse of "national defense" as *cynical* because our national crisis today, if it has any bearing on this issue, would direct that this of all times is the time when it should not be considered. A good cause should not have to be supported by mob propaganda and any sincere consideration of the national defense will suggest compelling reasons why this proposal should be left where the Senate threw it last year. Particularly when the Treasury itself admits that no substantial revenue could be obtained from this source for decades to come.

National defense calls for the fullest cooperation of states and municipalities, it requires the strengthening of their credit standing and the utmost efficiency in the administration of their local affairs. Other federal officials who are sincerely working for defense have called upon the states to provide roads, protection, water and many other emergency governmental services that the defense program requires. They are calling upon the cities to provide additional and emergency policing and fire-fighting services. On May 27th last the President himself called upon "loyal state and local leaders and officials to cooperate with the Civilian Defense agencies of the United States . . . and to put every community in order for maximum productive effort and a minimum of waste and unnecessary frictions." [3]

During the last war expenditures of cities increased about 10% and those of state governments about 30%. History is repeating itself. Our states and cities are again cooperating fully and spending freely to further the defense effort. Nothing would prove of

[3] Proclamation of an unlimited national emergency by President Roosevelt, May 27, 1941.

greater injury to defense cooperation than for the Federal Government to tax state securities, to increase our local interest costs and to effect, at this time, the disestablishment of that federalism which is the real strength of these forty-eight United States.

This is the very positive conclusion of the Coordinator of Civilian Defense, Mayor LaGuardia of New York, who said a few months ago that:

> ". . . this is no time for the Federal Government to cause irritations by seeking to tax municipalities or other subdivisions of the state. . . . That being so, I should think, at least for the period of the emergency, all attempts to tax municipal securities, . . . should be postponed. . . . And now, of all times, is the wrong time to make a change." [4]

Despite this patriotic appeal of the Coordinator of Civilian Defense, the Treasury continues its efforts to expand the powers of the central government and to bring the fiscal powers of the states and cities within its control. Treasury spokesmen assert that the sovereignty of the states is a thing of the past and they brand as reactionary those who take issue with that view. All this, despite the fact that such eminent and liberal authorities as Chief Justice Stone and Justices Brandeis and Cardozo have each concurred in the view that the federal power which the Treasury now asserts, is incompatible with that independence of state powers which is the basis of our entire constitutional system.

Coordinating their efforts, through the Conference on State Defense, the states and cities have so far defeated all attempts to tax the interest on their bonds by a so-called "simple statute." During the course of the 76th Congress, the state and municipal viewpoint was submitted both to a Special Senate Committee and to the Ways and Means Committee of the House. After hearing the reasons why such an extension of the federal taxing power would be unsound and unconstitutional, the Ways and Means Committee refused even to report such a measure to the floor of the House. Just a year ago in the Senate, the proposal was defeated by a vote of 44 to 30, which supported the report of Senators Austin of Vermont and Burke of Nebraska in complete opposition to the Treasury proposal. The real strength of the Senate's opposition, as indicated by the Congressional Record, was about 57 to 36.[5]

Early this year, the Treasury again renewed its efforts, first to have the Ways and Means Committee include federal taxation of municipal bonds in the debt limitation bill. Rebuffed by the Committee in this move, the Treasury then prepared a draft of a statute

[4] Address on April 30, 1941, Port Dedication Ceremony, New York City.

[5] Cong. Rec., Sept. 19, 1940, Vol. 86, p. 18621.

dealing solely with this issue, and finally attempted to have the proposal included in the general tax revision bill of 1941. They were promptly advised by Congressional leaders that further attempts to push the issue would invite a Treasury defeat not only in the Committee but even on the floor of the House.[6]

Thus, the Congress over a period of the past three years has manifested its determination to protect the interests and preserve the fiscal integrity of state and local government. Having come to the conclusion that our objections, both constitutional and economic, were sound, the Congress has not only disapproved the Treasury's recommendation for a tax on state and local obligations, but has insisted on the preservation of the basic doctrine of reciprocal constitutional immunity as between the Federal Government and the states.

One would expect that the Treasury would accept these repeated decisions by Congress especially when they give lip service to the soundness of the doctrine of reciprocal immunity. Early this year, the General Counsel of the Treasury, speaking on this subject, said:

> "No one has questioned the basic constitutional principles (1) that the federal government lacks power to tax in a manner which will destroy or substantially interfere with the exercise of state and municipal functions, and (2) that state and municipal governments lack power to tax in a manner which would destroy or substantially interfere with the exercise of the functions of the federal government." [7]

However, the Treasury continues to assert that a federal tax on state securities would not burden the issuing community. This, in spite of their own experience in paying higher interest rates on taxable federal bonds this very year.

Rebuffed by the Congress, they have now turned to the courts to seek what would amount to a judicial amendment of the Constitution. The Treasury's press release of March 14, 1941 says in part:

> "The Bureau of Internal Revenue tonight began a test action intended ultimately to prove in the courts that the Federal Government has the right under the Constitution to tax the income from State and municipal securities.
>
> "Its first step was to send notices of deficiency to seven holders of bonds of The Port of New York Authority who had not included interest from their bonds in their tax returns filed on March 15, 1938."

[6] *Wall Street Journal*, February 28, 1941.

[7] Address by Edward H. Foley, Jr. before Committee on Municipal Law of the New York State Bar Association, January 24, 1941, printed in *Legal Notes on Local Government*, April, 1941.

This makes it quite clear that the entire objective of the test cases against Port Authority bondholders was to have the courts "faced squarely with the broader Constitutional question of the immunity of State and municipal securities from federal taxation." In July, similar action was taken against two bondholders of the Triborough Bridge Authority, of New York.

Despite strategic disclaimers these actions attempt to establish federal power to tax *outstanding* state bonds on all of which the people of the states and cities have enjoyed the benefits of a tax exempt sale. In commenting on these test cases the New York *Herald Tribune* on July 22, 1941 stated:

> "As for the Treasury assertions that the court tests are not intended to pave the way for taxation of *outstanding* state and city bonds, most experts here hold them to be just so much eyewash. The court tests are precisely and specifically for the purpose of establishing the asserted right to tax outstanding tax exempts, and Treasury contentions to the contrary are amazing in the circumstances."

Indeed, when squarely asked for a frank commitment on outstanding bonds of state authorities and other state and municipal agencies, the Treasury hedged with the evasive reply that "it is considered inadvisable to express a definite commitment with respect to the matter at this time." [8]

Let us, therefore, consider the issues which must be raised in these cases. The legal issues may be reduced to two general considerations. The Supreme Court has said that it *will* enforce the immunity rule wherever a federal tax imposes a direct and substantial burden on the states. Therefore, we must consider (1) the fiscal and economic aspect, which is the foundation of (2) the constitutional and statutory basis of immunity.

FISCAL AND ECONOMIC CONSIDERATIONS

If the removal of tax exemption from state and municipal bonds results in an increase in the cost of their financing, no one can question but that such an increase would be a burden on the issuing government. Experts on governmental finance, including those of the Treasury, have always agreed that increased interest costs would naturally follow the taxation of local securities. The Treasury always contended that such an increase would be small and readily offset by other factors, whereas others have held widely different estimates on the cost factor. Professor Harley L. Lutz of Princeton, after an extensive study of the question, testified at Congres-

[8] Letter from Bureau of Internal Revenue to Robert A. Hall, of Philadelphia, July 10, 1941.

sional hearings that he thought the increase in interest rate to the states and municipalities would amount to about 6/10ths of 1% per annum. The Treasury criticized this figure as high, although Dr. Lutz stated that this 6/10ths of 1% estimate was "lower than that which competent persons in close touch with the bond market have suggested." Comptroller Tremaine of New York State believes the rise in interest rates would be from 1% to 2%. An interesting side-light on this question is the fact that Mr. Jesse Jones has for some time been insisting upon a contingent increase of ¾ of 1% in the coupon rate on all municipal securities purchased by the R.F.C., the increase to be operative immediately upon the enactment of a federal tax upon such bonds. Such an increase, ¾ of 1%, on a 3% bond would represent a 25% increase in the cost of municipal financing. Does the Treasury consider this a negligible burden?

But let us look at the facts in the light of the experience of the Treasury itself in issuing securities taxable by the Federal Government. Before the Federal Government authorized the elimination of tax exemption from Treasury securities, one of the Treasury experts speaking at a Congressional hearing said that "in order to measure exactly the value which the market is placing upon the tax-exemption feature of public securities, we ought to compare securities which are identical in every respect save that of tax exemption." [9] When this statement was made, there was no such comparison available, but since December, 1940, when the first issue of taxable Treasury notes of five years maturity was offered, state and municipal officials were given an opportunity to compare the taxable notes with similar outstanding tax-exempt Treasury notes! [10] The new notes were offered at par and carried a .75% coupon. On the same day, a Treasury note of like maturity but fully tax exempt was selling to yield .44%. The *New York Times*, commenting on the new issue, said:

> "If the new notes had been issued tax-free, as usual, the rate necessary would have been ½ per cent, the taxable feature making the difference of ¼% in annual interest."

In this case, the Treasury paid almost 50% more on short-term borrowing because the notes were taxable. A glance at the quotations in today's paper will show that these taxable notes maturing in 1945 sell to yield about 100% more than the tax-exempt notes due in the same year. The same spread may be observed between the

[9] Hearings before the Special Committee on Taxation of Governmental Securities and Salaries, United States Senate, 76th Congress, First Session, 1941, page 618.

[10] United States Treasury Notes issued prior to December, 1940 are totally tax exempt, whereas Treasury Bonds are exempt only from the normal federal tax and surtaxes up to holdings of $5,000 principal amount.

taxable and tax-exempt notes maturing in 1944. On the basis of the Treasury expert's statement quoted above, this would seem to be conclusive evidence that the elimination of tax exemption is costly.

In April an interesting study of this subject was published by the Conference on State Defense.[11] In this analysis of the Treasury offerings of over $2,000,000,000 of taxable securities through March 15, 1941, it was made clear that the removal of exemption had burdened the government substantially. Basing the cost to the Treasury on actual market quotations as of March 31, 1941, and using the Secretary of the Treasury's breakdown as to distribution of government issues during the preceding eight years, the following conclusion was reached:

1. The Removal of Tax Exemption Cost the Government in Increased Interest Yearly	$8,541,807.
2. Maximum Possible Return in Taxes to the Government Yearly	6,927,748.
3. Net Loss to Government Yearly on all fully taxable Treasury Financing to 3/15/41	1,614,059.

This conclusion was arrived at after every possible advantage was given to the Treasury. For example, to all commercial banks and insurance company holdings, the existing 24% corporate rate was applied and in the case of all individual and other holders the fantastic possibility was assumed that all the bonds would be held by taxpayers who paid the maximum rate of 79%.

The Federal Government, through its income tax, can retrieve part, at least, of its own loss. But even if the states were allowed to tax federal bonds, the increased cost of taxation of their own issues by the Federal Government would involve them in a huge net loss. They could recover very little, since many have no income tax, and where they do, it is small compared to the federal tax. Local governments would, of course, be able to recover none of this added cost and local government issues comprise over 80% of all state and local government indebtedness. Can the Treasury still deny that a burden would exist?

State and local officials realize that if the Federal Government with the highest credit rating in the world and its control of the money market, has to assume such a burden through taxing the interest on its own bonds, local governments with lower credit ratings, smaller flotations, and in many cases limited markets, would have to shoulder a far greater burden if their bond interest should be taxed. They realize further that this added cost would have to be passed on to the local taxpayer—the home owner and the rent payer. This is so because the increase in state and local interest costs will have

[11] Proof of the Pudding No. 2, April, 1941.

to be made up from higher state and local taxes. Now, it is elementary that local taxes which means by and large real estate taxes are largely regressive, having little relation to the ability to pay. In the final analysis, therefore, the little taxpayer with whom this proposal has been popularized, as a measure that will "soak-the-rich" and "aid national defense," will himself have to pay the bill.

And still proponents of elimination of tax exemption speak of exemptions defeating the progressive tax system. This argument is an old Treasury favorite. They re-echo again and again that tax-exempt bonds are a means of tax avoidance by the rich and defeat progressive taxation. One of the Treasury's own experts, Professor Kossuth M. Williamson, answered this complaint. In a recent article [12] on this subject, he said:

> "The extent of evasion by the rich, through tax-exemption, has been exaggerated by opponents of tax exemption. Available studies of the composition of estates at death fail to show any decided or exclusive concentration of the rich upon tax-exempt securities. Studies of income tax data also tend to confirm this fact."

And again,

> "Insofar as the present statistical evidence does reflect actual investment behavior, the failure of the wealthy to invest wholly or to a larger extent in tax-exempt securities is probably explained by a desire for control in business—whatever the explanations, experience so far does not support the contention that tax exemption nullifies the progressive feature of the income tax or that the progressive income tax and tax exemption cannot exist together." [13]

Since the beginning of the present national emergency, states and municipalities have been retrenching, knowing only too well from experience in the last war that they will be called upon for extraordinary expenditures in the extension of municipal services. Many cities and states have executed or planned huge refunding operations to insure lower cost of debt service. You all, no doubt, recall the 136 million dollars Arkansas refunding deal, the one in which Federal Loan Administrator, Jesse Jones, decided that the rate was "too high for a tax-exempt bond of a sovereign state." Such re-

[12] *Annals of the American Academy of Political and Social Science*, March, 1941, p. 69, "The Case for Taxation of Governmental Securities."

[13] Professor Williamson also took up the question of cost of issuing taxable securities, and after examining the estimates of the Treasury and those of Dr. Lutz, he said: "Whatever the over-all gain, however, it is generally admitted that the state and local governments will lose in increased interest cost more than they will gain from the taxation of federal interest."

fundings would be utterly impossible if the interest rates were jacked up by the taxation of local bonds.

Carl H. Chatters, Executive Director of the Municipal Finance Officers' Association, said: "Smaller communities will find it difficult, if not impossible, to market their bonds at all."[14] The head of the municipal bond department of one of the large Chicago banks told him that "he would cease to purchase municipal bonds in the smaller communities if the tax-exemption were removed." Does the Treasury still think there is no burden?

CONSTITUTIONAL CONSIDERATIONS

I submit that an increase in state and local taxes is a definite and tangible burden on local government, within the tests most recently proposed by the Supreme Court in *Helvering* v. *Gerhardt*[15] and *Graves* v. *New York, ex rel. O'Keefe*.[16] The Court there declared that immunity will be maintained when the proposed tax actually threatens to burden state or municipal government. This principle was the basis of the decision in the famous *Pollock* cases,[17] in which the Court held that the Federal Government lacks the constitutional power to tax state and municipal bond interest.

While Treasury spokesmen admit the unconstitutionality of their proposal under the doctrine of the *Pollock* cases, they argue that the Court will reverse that decision at the first opportunity. I cannot find any reasonable basis for such an argument.

The Treasury seems to hope that the recent decisions indicate a readiness on the part of the Court to hold state bonds taxable. That this expectation is based on wishful thinking, rather than the views of the Court, is clearly indicated by the very decisions on which the prophecy is based. Thus, in *Helvering* v. *Gerhardt*, in which employees' salaries were held taxable, the Court went out of its way in its opinion, to express the continued validity of the doctrine of intergovernmental immunity as expressed in the *Pollock* case. Again, in the *O'Keefe* case in which the doctrine of the *Gerhardt* case was reiterated, the then Solicitor General, Robert H. Jackson, now a Justice of the Supreme Court, explained the great difference between the taxation of public salaries and the taxation of interest on government securities. He said it was apparent that in the case of securities one was dealing with a debtor and a creditor relationship, where the borrower was bound to be burdened by the tax. The Treasury's arguments are not new. They have been presented to and rejected by the Supreme Court. Nevertheless, the Treasury De-

[14] *Annals*, p. 74.

[15] 304 U. S. 405.

[16] 306 U. S. 466.

[17] *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429; 158 U. S. 601.

partment is pressing them again, as support for their assertion of a supreme federal power to tax the states.

Let this be clear. The salary cases surely reject any immunity where no true burden upon a governmental function can be shown. But just as surely do they make it clear that where that burden does exist, the tax will be struck down as an unconstitutional violation of sovereignty. And who can deny the burden in the case of a tax on state and local obligations? Who will deny the substantial interest differential the tax would cause? Who is so blind as not to see the tremendous cost burden the tax will thrust upon state and local government? And who will close his eyes to the throttling effect the tax would have on the state and municipal power to finance their governmental operations free from federal interference?

But the Treasury has resurrected another argument. It is an old chestnut which holds that the 16th Amendment must be interpreted to give the federal government the power to tax the states without any limitations and without any considerations of sovereignty.

The 16th Amendment, you will recall, provides that the Congress may levy income taxes "from whatever source derived, without apportionment, among the several states." The record shows that when the Amendment was before the Senate and House, the question of taxing state and municipal securities was not discussed.

It was not until 1910, after the resolution had been adopted by the Congress and was before the states for ratification, that the question was first raised. Governor Hughes of New York then suggested in a message to the Legislature that while he believed that the states should confer upon the Federal Government the power to lay and collect an income tax without apportionment, nevertheless the phrase "from whatever source derived" might, if taken in its natural or dictionary sense, and stripped of its context in the Constitution, be construed by *some* to permit the taxation of state and municipal securities. The fears which he voiced in 1910 are being realized now. For it is now urged by the Treasury Department that the effect of the Amendment was to grant supreme taxing power to the federal government, not only over the income from state bonds, but over the income of the states themselves.

Immediately after Governor Hughes expressed his fears Senator Borah rose on the floor of the Senate and took sharp issue with the interpretation feared by the New York Governor. He knew well that if the states suspected any purpose to tax their securities the Amendment was doomed. He reassured the states that it was not the intention of Congress to extend the federal taxing power to this field. It was simply intended, he said, to permit a valid levy on otherwise taxable income *without apportionment.* Similar views were expressed by Senator Brown who introduced the Amendment, and by Senator Elihu Root.

Not once did anyone, either in the Senate or House, rise to challenge the views expressed by Senators Borah, Root and Brown. And ultimately the views expressed by these great constitutional lawyers were adopted by the Supreme Court itself.

Thus, in *Brushaber* v. *Union Pacific R. R. Co.*,[18] *Stanton* v. *Baltic Mining Co.*,[19] and in *Peck & Co.* v. *Lowe*,[20] the court refused to interpret the Amendment as extending the federal taxing power to include subjects not theretofore taxable. In *National Life Insurance Company* v. *United States*, fifteen years after the adoption of the Sixteenth Amendment, the court said: ". . . the United States may not tax state or municipal obligations." And in *Willcuts* v. *Bunn*, Chief Justice Hughes, writing for a unanimous Court, said:

> "In the case of the obligations of a state or of its political subdivisions, the subject held to be exempt from federal taxation is the principal and interest of the obligations (citing the Pollock case), supra. These obligations constitute the contract made by the state, or by its political agency pursuant to its authority, and a tax upon the amounts payable by the terms of the contract has therefore been regarded as bearing directly upon the exercise of the borrowing power of the government."

I may say that of the twenty-two cases that have cited the *Pollock* case with approval and stated the bond immunity rule, eighteen were decided *after* the adoption of the Sixteenth Amendment.

Let there be no mistake as to the sweeping extent of the power which the Treasury is seeking to establish. In a study submitted by the Department of Justice, it is claimed that while the federal government must continue as immune from state taxation, yet that principle does "not necessarily shield the states against the exercise of the delegated, and supreme, taxing power of the central government." In the letter transmitting the same study to the Treasury Department, it is asserted "that ordinarily tax immunity is a privilege of federal, not state instrumentalities."

Thus, the objectives of the proposal become clear. It seeks to establish plenary power in the federal government to tax, not only the interest on state bonds but to bring every power and function of states and their instrumentalities within the tax control of the federal government.

The power to tax carries with it a definite power to control, and when the federal government can control the operations of the states, dual sovereignty is at an end. Let it be clear that the

[18] 240 U. S. 1.

[19] 240 U. S. 103.

[20] 247 U. S. 165.

Treasury offers the states only a repealable *permission* to tax federal securities, but asserts an absolute federal *right* to tax the states at will. Such " reciprocity " is a sham.

The only real guarantee of reciprocity is the guarantee now afforded by the Constitution. Under our system of dual sovereignty, tax interference by one government with the necessary functions of the other, can only be prevented by reciprocal constitutional immunity. The withdrawal of that protection from one of the two sovereigns must ultimately result in the subjection of the states and the collapse of our system of federated democracy.

After the Treasury's attempt to tax state and local bonds had been decisively defeated in the Senate last year, Senator Austin of Vermont, who had in many respects been the leader of the fight on the Senate floor, was heard to remark that if the people only understood the real issue that had been fought out in the Senate, they would realize why, so far as concerned the future form of the American Government, it was the most vital and important issue that came before the Senate in the 76th Congress. Fundamentally, that issue is a simple one and should not be lost in a maze of conflicting economic argument. To anyone who really understands the history and philosophy of our Constitution, it is clear that the one great issue here is the continuance of state and local self-government in America, which has always been and still is the backbone of democratic society.

CHAIRMAN CUSHING: Thank you, Mr. Epstein, and congratulations to the Empire State of New York. States' rights are not altogether dead, after all. A lot of us are glad to hear that.

The next speaker upon the program is not Lawrence H. Seltzer. He has prepared the paper, but was unable to be present. He has sent his paper to be read by Charles F. Keyes, an attorney of Minneapolis.

I think we should say also that Mr. Keyes is not only a lawyer, but president of the Minneapolis Taxpayers Association. He was formerly a city official, so he should be somewhat judicial, and see the point of view from both sides.

CHARLES F. KEYES: Mr. Chairman, Ladies and Gentlemen: This paper was prepared by Professor Seltzer of Wayne University, who is also connected with the National Bureau of Economic Research, and represents the views of an economist. As I read his paper, you will probably agree with me that it is that of a New Deal economist.

However, it will, of course, be understood that I am simply the mouthpiece, transmitter, and do not necessarily agree with what he says.

POSSIBILITIES OF SPEEDING THE ELIMINATION OF TAX-EXEMPT SECURITIES

LAWRENCE H. SELTZER
Professor of Economics in Wayne University

1. THE ATTACK UPON THE CONSTITUTIONAL OBSTACLE

Four outstanding developments in the long controversy over tax-exempt incomes have occurred since 1939:

First, on March 27, 1939, the Supreme Court of the United States, in its decision in *Graves* v. *O'Keefe*, swept away completely the previously presumed immunity of governmental salaries from income taxes. In ruling that all officers and employees of the federal and state governments are taxable by both governments, the court followed the tenor of its other recent decisions in this field,[1] emphasizing that a non-discriminatory tax upon the private income received from public employment imposes no undue burden upon the employing government.

Second, by the Public Salary Act, approved April 12, 1939, Congress availed itself of its newly-discovered power: it subjected the salaries of state and local government officials to the federal income tax and authorized like taxation of federal employees by the states.

Third, by an act approved February 19, 1941, Congress provided that on and after March 1, 1941, all further issues of obligations of the federal government and its instrumentalities shall be fully subject to federal taxation.[2]

Fourth, on March 14, 1941, the Bureau of Internal Revenue initiated court proceedings against seven bondholders of the Port of New York Authority, and on July 19, 1941, against two bondholders of the Triborough Bridge Authority, with the avowed intention, in the words of the Treasury press release on the latter date, "ultimately to prove in the courts that the federal government has the right under the constitution to tax the income of state and municipal securities."

On the other side of the ledger is the fact that despite the strong recommendation of the President in two special messages to Congress for a statute subjecting future issues of state and local government securities to federal taxation, and permitting state taxation of federal securities, no such measure has reached the floor of either the House or the Senate during the past two years. Hearings on the proposal were held in 1939 before the House Ways and Means Committee and before a special committee of the Senate. The latter rendered a favorable report, and its chairman, Senator Prentiss M.

[1] *Cf.* particularly, *Helvering* v. *Gerhardt*, 304 U. S. 405, May 23, 1938.

[2] The act does not apply to Territories and Possessions of the U. S., nor to the District of Columbia.

Brown of Michigan, offered a bill embodying the proposal as an amendment to the measure which became the Second Revenue Act of 1940; but the matter got no further.

This refusal to act — or was it only a postponement? — may be attributed to several factors, including, particularly, the strong opposition of state and local government officials; but even a cursory reading of the Hearings indicates that doubt respecting the constitutionality of such a measure exercised an inhibiting influence. This doubt could be greatly lessened or removed in the near future by court decisions in cases now pending; or, under the spur of another presidential recommendation, Congress may decide to invite a decisive test of the constitutional question by swallowing its doubt and enacting the President's proposal.

If the Supreme Court were now to limit the implications of its recent opinions in this field, and to intimate or declare that federal taxation of the income from state and local government securities would be unconstitutional, the prospect for early action to stop the further issuance of tax-exempt securities would become exceedingly dim; for even if Congressional approval of the then-necessary amendment to the constitution could be obtained, the inaction or disapproval of only 13 states would be sufficient to postpone or prevent its adoption. Clearly, the possibility of speed in the elimination of tax-exempt securities depends in the first instance upon the tenor of forthcoming decisions of the Supreme Court.

2. THE ECONOMIC ISSUES

The principal criticisms which economists commonly make of the exemption of state and local government securities from the federal income tax have been so often repeated that they need little elaboration here.[3] They may be summarized as follows:

1. The revenue loss to the federal government is greater than the interest saving to the state and local governments. Interest rates on tax-exempts do not go low enough to offset the tax advantage of the securities to very wealthy investors because the securities are issued in such volume that they must carry interest rates sufficiently high to appeal also to many who are subject to relatively low surtaxes. The Treasury Department estimated in 1939 that while, under certain assumptions, the elimination of the tax-exempt privilege might eventually cause the interest costs of state and local government to be higher than they would otherwise be by an amount between $40 millions and $105 millions annually, it would be likely

[3] For a comprehensive recent discussion, see particularly the statements and exhibits of the Treasury Department and its witnesses in the *Hearings* before the Committee on Ways and Means on *Proposed Legislation Relating to Tax-exempt Securities*, and in the *Hearings* before the Special Committee on *Taxation of Governmental Securities and Salaries*, of the Senate, both of the 76th Congress, 1st session.

to increase the federal revenues by about twice as much—by an amount between \$107 millions and \$198 millions annually.[4] Because very substantial increases in corporation and individual income tax rates have taken place since these estimates of revenue were made—the 1938 Revenue Act was the basis of the estimate—the gain to the federal government would now be estimated at considerably more. On the other hand, the higher tax rates and the termination of federal issuance of tax-exempt securities have increased the power of the tax-exemption privilege to cut the interest costs of state and local governments.

2. Tax-exempt securities create inequalities between taxpayers because the immunity from income tax has a greater value for those with high incomes than for those with low incomes. Under the Revenue Act of 1941, a three percent municipal bond returns the same income after taxes as a four percent corporation bond for an investor with other net income of \$10,000; but it is as good as 9.38 percent return on a taxable bond for an investor with other net income of \$100,000.[5] Table I, appended hereto, shows both the growth in importance of tax-exempt securities as components of estates in recent years and their relatively greater importance in larger than in smaller estates.

3. Further inequalities are created whenever tax rates are increased. In an emergency like the present, for example, the holders of outstanding tax-exempt securities not only continue to enjoy their immunity from the previous scale of tax rates; they also escape the necessity of making any contribution toward supplying the additional needs of the government. At the same time, the exemption of their income from participation in supplying the government's new needs adds to the fresh burden that must be imposed upon other forms of income. It does not appear that the issue prices of tax-exempt securities have commonly included any significant payment for this immunity from future increases in tax rates; yet, in retrospect, this immunity has been of great value. A married man with other net income of \$50,000, who purchased a three percent municipal bond in 1929 obtained a net return after taxes equal to that of a corporation bond yielding 3.61 percent; but under the 1941 Revenue Act, such a man will derive as high a net return from his three percent municipal as he could get, after taxes, from a corporation bond yielding 7.32 percent. In an emergency requiring extraordinary tax increases, this kind of inequity is likely to be particularly offensive to the public's standards of fairness. Table II, appended hereto, shows the increased value of tax exemption in 1941 as compared with 1929.

[4] House *Hearings*, op. cit., Exhibit 12. The estimates were presented as a range between the lower figures, resting upon more conservative assumptions, and the upper figures, resting upon more liberal assumptions.

[5] \$1,500 personal exemption assumed. See Table II.

(4) The availability of tax-exempt securities offering attractive tax-equivalent yields operates to divert the investment funds of the wealthy into these safe havens and reduces the readiness of such investors, who, as a class, are best able to assume business risks, to commit their capital to venturesome undertakings. With the availability of "venture capital" being reduced by other forces, such as the increasing importance of insurance companies, banks, and trustees of various types as managers of investment funds, it is doubly undesirable to offer added encouragement to riskless investment by immunity from taxation. A general trend toward an increasing concentration of tax-exempt securities among the wealthiest elements in our population is indicated by the federal estate tax returns in recent years: figures for the years 1928 to 1939, inclusive, are presented in Table I, p. 197.

3. THE OPPOSITION TO THE ELIMINATION OF TAX-EXEMPT SECURITIES

The opposition to the elimination of tax-exempt securities does not rest primarily upon an analysis of the general economic factors involved. In fact, little attempt is usually made to deny the general merit of the economic considerations just cited.[6] Apart from the constitutional argument, which no one but the Supreme Court can settle, the objections are of three kinds:

There are some, like the solicitor-general of the State of New York, who preceded me on the platform this evening, who appear to hold that the removal of tax-exemption will inevitably lead to the decay of our municipal institutions and to an extreme centralization of government, with the consequent death of democracy. With this type of argument, I do not propose to deal, other than to say that these fears seem to me to be grossly exaggerated; that they are not supported by the experience of other countries; and that relatively few persons appear to share them.

There is another group which opposes the elimination on the ground that although the change would make for some improvement in equity, its revenue contributions would be too small and too long-delayed to justify the difficulties and disturbances of transition. The weight that can properly be attached to this type of consideration varies greatly with changing circumstances. During the later 20's, when personal exemptions under the income tax were high, and surtax rates low, the inequities arising out of tax-exempt securities were relatively inoffensive. But with personal exemptions reduced to very low levels, corporation income tax rates raised to 30 percent and more, and individual income tax rates substantially increased in the lower and middle brackets, considerations of equity assume an

[6] Professor Harley L. Lutz is a spirited exception: *cf.* House and Senate *Hearings,* op. cit.

enhanced importance. Fairness in taxation is desirable at all times; it is urgent when taxes must be high.

The third and most meritorious kind of objection to the stoppage of further issues of tax-exempt securities, and the one which is the core of all active opposition to the proposal, is that the gain in federal revenues would be accompanied by an increase in the interest costs of state and local borrowing. This is undeniable. The Treasury Department has estimated that the change would have raised the typical 1937 borrowing rate from 3.25 percent to something between 3.50 and 3.90 percent.[7] The impact of the rise would be felt most by local governments, whose securities constitute not far from 90 percent of the total amount of state and local government debt outstanding, and whose revenue sources are so largely dependent upon the property tax. An absolute increase in the interest costs of local governments, brought about in this manner, would constitute a dead weight addition to their expenses—an increase which would have no offset in additional public improvements or additional operating services. In the light of the great disparity which already exists between the volume of their governmental services and their limited fiscal resources, the presumption is decidedly against any unnecessary increase in the financial burden of local governments.

Moreover, although the privilege of issuing tax-free securities constitutes an undeniable, though a hidden, subsidy to state and local governments, it is a subsidy of very long standing. Its age alone creates a presumption against violently removing it, for adjustments have been built up to it, and, other things being equal, its elimination would entail unanticipated readjustments, such as an increase in property taxes.

While the foregoing considerations cannot be ignored, it should also be observed that their practical import is greatly qualified by the enormous decline in the general level of interest rates that has taken place in recent years. This decline has been so great that only part of it would be offset, in the case of state and local government securities, by the removal of their tax-free privilege. In consequence, if the existing obligations are refunded as they mature by fully taxable securities, the state and local governments would still experience an absolute decline in their interest costs, unless the general level of interest rates should rise substantially. In other words, the practical effect of stopping their issuance of tax-exempt securities at this time would not be an absolute increase in their interests costs, except on new borrowing, but rather a smaller decline in interest costs than they would otherwise enjoy. From this standpoint, there could be no better time than the present to eliminate tax immunity.

[7] House *Hearings*, op. cit., Exhibit 14.

In my judgment, the conflicting considerations that I have cited could be best reconciled by stopping the further issuance of tax-exempt securities and, at the same time, arranging to compensate the state and local governments for the resulting loss of a long-established subsidy. One simple method of providing compensation would be for the federal government to agree to make annual or semi-annual payments for a stipulated number of years to all state and local governments in amounts equal to 15 percent or thereabouts of their interest charges on all fully taxable obligations that they come to have outstanding. This method of compensation can most nearly approximate the amount and distribution of the disguised subsidy of tax immunity that has so far been provided; and it avoids the necessity for special treatment of governmental units whose interest charges are atypically low or high.

At the end of the stipulated period, the subsidy might be removed or progressively reduced; or it might conceivably be replaced by an act providing for the payment to state and local governments of federal contributions equal to the taxes that would be payable on the federal properties located in the various jurisdictions (the public domain excepted), if these properties were privately owned.

4. SPEEDING THE ELIMINATION OF OUTSTANDING TAX-EXEMPT SECURITIES

I turn finally to consider briefly the possibilities, such as they are, of speeding the elimination of outstanding tax-exempt securities.

So far as federal securities are concerned, the problem will largely disappear of itself in a relatively short time. Except for less than $200 millions of bonds issued under statutes antedating the World War, all the fully tax-exempt securities of the federal government and its instrumentalities become due or callable by 1946. The greater part of them consists, moreover, of low interest-yielding bills and notes. Further, even the greater part of the privately-owned federal securities that are exempt only from normal tax will become due or callable by 1948.

The situation is different with respect to state and local government securities. As of June 30, 1940, the aggregate outstanding amount of these approximated $20 billions, of which $1.5 billions was held in state and local sinking funds.[8] Assuming that the present distribution of maturities is not greatly different from that of June 30, 1937, as estimated by the Treasury Department—the short-

[8] *Annual Report of the Secretary of the Treasury* for 1940, Table 64. State and local trust and investment funds also held about $2.5 billions, and federal agencies, about half a billion, but both of these holdings constitute potential additions to the supply available for private investors. They might readily be sold if their prices rose sufficiently above those of federal obligations. Corporate investors held about $7 billions, and individuals, including trusts, about $8.5 billions.

ening due to the passing of time being offset by the refunding of maturing issues and the creation of new long-term debts—only 40 percent of the aggregate state and local government debt will mature in the next 10 years. Further, very little of it is callable in advance of final maturity; and the final maturities stretch out for half a century.[9]

To make matters worse, the maturing tax-exempts that are replaced by fully-taxable securities during the first 10 or 15 years after the termination of tax-free issuance are not likely to reduce the tax-exempt holdings of those who derive the greatest tax advantage from them. The latter will replace their matured securities with other tax-exempts purchased in the open market from those to whom the tax immunity is of lesser value. The holdings of charitable organizations, mutual insurance companies, and individuals subject to low surtaxes will constitute a reservoir from which corporations and wealthy individuals will be able for some years to replenish and even to increase their portfolios of tax-exempts by open market purchases. And as the total amount outstanding shrinks, it will tend to become progressively more concentrated in the hands of those subject to the highest income tax rates.

This prospect has been discouraging to many. On the other hand, relatively few persons, and none in high position, so far as I know, have advocated the withdrawal of tax immunity from securities already outstanding. There is widespread agreement that investors who purchased such securities in good faith should not be made to incur serious losses by a change in the traditional interpretation of the constitution and a corresponding change in the income tax law. If we accept this point of view, as I do, the question becomes: Are there any means nevertheless open to us to speed the elimination of outstanding tax-exempt securities? I think there are, provided we want the elimination badly enough.

I ventured to suggest above that annual or semi-annual cash payments to state and local governments for a stipulated number of years in amounts equal to 15 percent or thereabouts of the interest charges on all fully-taxable bonds that they come to have outstanding would be a good substitute for the present subsidy given by the federal government in the form of tax immunity. The same device could be used for this additional purpose. By making the amounts of the cash payments somewhat greater than the added interest costs to state and local governments of substituting fully-taxable for tax-free securities, the federal government could provide these governments with an inducement to speed their refunding operations as much as possible. They could be induced to offer voluntary exchanges of securities to their investors in advance of maturity. The

[9] House *Hearings*, op. cit., Exhibit 17, and footnote 2 of Exhibit 16.

advice and cooperation of the Reconstruction Finance Corporation and the Securities and Exchange Commission could be made available to them in connection with such refundings. We have noted that some classes of holders of state and municipal securities do not benefit significantly from the tax immunity, and they, at least, might respond readily to exchange offerings bearing higher interest rates. If the payments of the federal government were made especially generous in connection with voluntary exchanges of securities accomplished during the first two or three years after the Congressional enactment, an added incentive to early refunding would be provided.

This method of attack is subject to the criticism that it might be unduly expensive. Only those for whom the tax immunity is of little value might convert. Even many of these might prefer to hold, in the hope of selling their securities to the rich at fancy prices as the total supply dwindled. And the rich might be stimulated to gobble up quickly all the tax exempts that they could lay their hands on, for fear the supply would soon be exhausted. But much would be done to offset this weakness if Congress provided that the tax immunity of outstanding securities would be continued only so long as they remained in the hands of those who owned them when the act was passed (or in those of the direct successors of deceased investors). In that case, the value of tax-exempts for speculative holding would be removed, and many who would not otherwise take advantage of the voluntary refunding offers would do so. Further, the federal government would gain greatly by the prevention, in this manner of all further transfers of tax-exempt securities from those with smaller tax liabilities to those subject to higher rates.

Whether it would be justifiable to subject the investor in tax-exempt securities to this degree of coercion and possible injury is a debatable question. The argument of the affirmative might run like this: The investor has made a contract with a state or local government, not with the federal government. He has paid a price for his tax exemption in the form of a reduced interest return, but he has paid it to the wrong party—the state or local government. The federal government recognizes, however, that he had good reason for misapprehending the law, and wishes to give him every consideration. But it does not want this consideration to be transferable, at a loss to itself, to those who seek to acquire these securities after the change in law has been established. Hence, the government says: "We will continue to grant you immunity from income taxation because we do not wish you to suffer a serious loss from an arrangement into which you entered in good faith. But we will not continue the tax immunity of your security in the hands of anyone else. If you should desire to liquidate your tax free bond, you may sell it minus its tax immunity, or you may exchange it for

a taxable security offered by your state or local government, and sell the latter. You may, of course, sustain some loss even then, if your old security happens to bear a very high coupon rate. But you have the option of continuing your tax-exempt status to the final maturity of that security, if you prefer." I leave further debate of this issue to others.

Finally, a great deal could also be accomplished to speed the elimination of tax-exempt securities if we were willing to undertake a public campaign of moral suasion to induce the holders to take advantage of the voluntary conversion offers which the state and local governments could make. It is well known that Great Britain was strikingly successful in employing this method to bring about her huge voluntary debt-refunding, at substantially lower rates of interest, in the 30's.

These are definite possibilities. Obviously, they require great initiative and the expenditure of considerable energy. For that reason, they are unlikely to be used unless the demand for the speedy elimination of tax-exempt securities reaches a high and sustained pitch.

TABLE I

FEDERAL ESTATE TAX RETURNS: PERCENTAGE OF AGGREGATE FEDERAL AND STATE WHOLLY EXEMPT SECURITIES HELD TO GROSS ESTATE,[a] BY SPECIFIED ESTATE SIZE CLASSES, 1928–39

	Size of net estate before exemption (in thousands of dollars)						
Year	100–200	200–300	300–500	500–1,100	1,100–2,600	2,600–5,100	5,100 and over
1928...	2.3	2.9	3.5	6.0	10.4	7.4	9.0
1929...	2.1	2.4	2.8	5.5	8.2	11.8	6.1
1930...	1.8	3.1	4.0	4.6	6.2	12.5	14.7
1931...	2.3	3.2	5.0	7.1	10.4	8.2	15.9
1932...	2.6	3.1	6.1	10.1	12.3	16.4	22.8
1933...	3.7	6.2	8.8	14.0	24.7	38.2	28.6
1934...	4.5	6.1	8.4	13.4	25.0	39.0	40.1
1935...	4.7	7.4	9.4	14.9	17.0	26.6	22.8
1936...	3.7	7.0	7.5	10.2	22.1	18.5	13.8
1937...	3.7	6.4	7.1	10.9	13.8	17.4	15.3
1938...	3.5	5.5	6.5	10.5	13.9	14.4	44.6
1939...	3.7	5.2	9.5	15.4	15.9	23.5	38.2

[a] Gross estate including exempt insurance.

Source: Treasury Department, Division of Tax Research.

TABLE II

INCREASED TAX ADVANTAGE DERIVED FROM TAX-EXEMPT SECURITIES IN 1941 AS COMPARED WITH 1929, AND VARYING VALUE OF TAX EXEMPTION FOR DIFFERENT INCOME LEVELS, FOR SELECTED CASES

Gross annual yield required on taxable securities to provide the same net yield after federal income taxes as on wholly tax-exempt three percent and four percent bonds at par, in 1929 and 1941.[a]

Net Income from Other Sources	Taxable Yield Required to Equal 3 percent Tax-exempt Yield		Taxable Yield Required to Equal 4 percent Tax-exempt Yield	
	1929	1941	1929	1941
$ 5,000	3.05	3.45	4.06	4.60
10,000	3.09	4.00	4.12	5.33
20,000	3.30	5.17	4.40	6.90
50,000	3.61	7.32	4.82	9.76
100,000	3.95	9.38	5.26	12.50
500,000	3.95	12.50	5.26	16.67
1,000,000	3.95	13.64	5.26	18.18

[a] For a head of a family, without dependents, whose income from additional investments, if taxable, would not be large enough to cause any part of it to be subject to a higher tax rate than that applicable to the last segment of the previous income. Figures for 1941 based on Revenue Act of 1941; those for 1929, upon the Revenue Act of 1928 as amended by the Joint Resolution, No. 133, approved December 16, 1929.

CHAIRMAN CUSHING: Thank you, Mr. Keyes, for reading this paper, which differs so much from the ideas we debated in the fight we had between the states' rights and the federal rights, centralized power; but it was interesting to me in its demonstration of many different possibilities that it has attempted to eliminate the tax-exempt securities of states and cities.

I know that there are a great many here who are very anxious to talk about this. We have exponents of centralized power here, as well as exponents of states' rights, and we are waiting to hear from anyone who wishes to speak.

ROBERT C. BROWN (Indiana): There is one point that seems to me to have been missed somewhat in all this discussion. I personally feel that this thing won't be done unless we eliminate the exemption of existing securities by some such stunt which I think is very unfair. But passing that point, it seems to me there is another very serious point. Suppose the thing is done, and then the federal government passes a statute which says merely that all income from federal securities shall be exempt from all state and municipal taxes. What are you going to do then? In my opinion, that would be perfectly constitutional. The Supreme Court has clearly indicated that.

You will recall that two or three years ago the Supreme Court decided, Mr. Justice Cardozo writing the opinion, that Congress had subjected preferred stock of the national government held by the RFC to state taxation, and Congress promptly passed a statute which eliminated the tax, exempted them from state taxation.

More recently in the *Pitman* case the Supreme Court clearly indicated that the federal government can exempt any of its functions from all state taxation.

If you have a situation where state and municipal bond income is subject to federal taxation and the income from federal bonds and so forth is exempt from state and municipal taxation, then I personally agree with all these demagogues who say that the states and the municipalities will soon go out of business.

CHAIRMAN CUSHING: Who else has anything to contribute to this very interesting subject.

Professor Lutz has been misquoted in the course of a paper. Were you here, Professor?

HARLEY L. LUTZ (New Jersey): I am very sorry, Mr. Chairman, I was not here when my name was taken in vain.

CHAIRMAN CUSHING: It was with reference to your testimony before Congress about this subject. I wondered if you wouldn't have something to say on the subject. We would like to hear from you.

MR. LUTZ: I didn't come here tonight to make a speech on this particular topic. I am reserving my ammunition for another occasion. But I couldn't help being impressed by the solution that was offered in the last paper.

In the first place, the author of that paper described this tax exemption or tax immunity status of state and municipal bonds as a subsidy granted by the federal government to the states. I am not acquainted with that writer, but I couldn't help recalling the characterization which the gentleman made of him when he began to read the paper. You will recall yourself what that was. I immediately thought, "That is a very natural and inevitable way of thinking for persons in that category. They think of everything in terms of a subsidy." And you will notice as he went on he proposed another subsidy to cure the first subsidy. That is fine business if you can do it and if we can afford to do it.

As a matter of fact, it isn't a subsidy. The complaint has been made by a great many people in the Treasury and out of it that the tax immunity status of state and municipal bonds is in the nature of a subsidy from the federal government, something which it has given as an act of grace, something for which there is no counterpart on the other side. Of course, if you are going to talk about the balance sheet of the fiscal relations between the federal govern-

ment and the states, and simply bring into the picture the taxable status of all of the federal property in all of the states, it comes down to the net balance of who is paying to whom a subsidy. I think you will find that the states and cities are subsidizing the federal government a great deal more than the federal government is subsidizing the states. It certainly surpasses the uttermost bounds of absurdity to talk about remedying whatever inequity there may be in the present situation by having the federal government dig up another 15 percent of the state and municipal interest bill and pass that around.

You can imagine where you are going to come out with that. It isn't necessary to comment further on that.

I should like to touch on one phase of the subject which now unfortunately has been closed by the Supreme Court, but in which in my judgment the Supreme Court was as profoundly in error as it has been on some occasions that we won't go into here. That was the question of the effect of taxing public salaries.

You will recall—I am not going to try to quote these decisions verbatim, or I may not give you a correct idea of them in substance—but in general the argument was of this sort: a public employee is a person and the federal government approaches him to levy a tax on his salary income, just as they would tax anybody's salary income, and since most people who are working for salary are in no position to go to the boss and say, "Now, I must have more money because my taxes have gone up," consequently there can be no burden upon a state or municipal government as a result of the federal tax imposed upon the salaries of state and municipal officials.

I am sorry to say that among the authorities quoted in that decision, I think I found a reference to one of my books, in which I had said something about the impossibility of shifting a tax that was levied on the income of a person on salary. When I wrote that, I think I was thinking about my own experience, more than anybody's else, because I am dead certain that I had never been able to jack my salary up by any complaint over the taxes that I had to pay.

But I did not fully take into account the leverage that a public employee has on his rate of pay. As a matter of fact, the ink was not dry on the court decision in the salary cases before we had a demonstration of the error of the logic in that decision.

The Republican majority of the legislature of New York State brought out a study of the ways and means of reducing the cost of state government in New York; a laudable objective. They reviewed various ways and various points at which they might cut the cost of state government and presently they came to the question of salaries.

They said that, "While we have no intention of recommending a flat percentage reduction of all salaries, we did consider for a time the possibility of making adjustments in certain of the salaries, because in view of all the circumstances we thought that the taxpayers had a right to some saving such as might be accomplished by salary reductions. But, in the meantime," the report went on to say, "the federal government has already cut those salaries by sustaining the applicability of a federal income tax on them, and it would not therefore be just and equitable in our opinion for us to attempt to cut them again."

In other words, there you have the situation in which a legislature comes out through a committee and says, "If it hadn't been for the federal income tax, we would have made certain salary reductions in the interest of the public economy. We can't do it." Therefore, I leave it to you to decide on whom the real burden of the tax on public salaries falls.

I remember that last year, that is, this summer a year ago, Mr. Morgenthau, testifying before the Ways and Means Committee with respect to certain matters connected with revenue and finance, made the point very specifically that we should not consider a reduction of federal salaries, because the salaries of federal employees are subject to income tax the same as anybody else, and therefore we must not consider a reduction of their salaries.

In other words, we already have proof out of the mouth of the Secretary of the Treasury himself that the burden of income must fall on the taxpayer. They could do things to the scale of public salaries if they were not subject to this tax, that we don't dare do and don't want to do because they are. Consequently, the burden of that tax is back upon the backs of the taxpayers, along with the burden of the tax on state and local bond interest, if that sort of scheme should be put through.

Just one other word, Mr. Chairman: there has never been any convincing reason given why this matter should not be handled by constitutional amendment. The one reason that is advanced is that it would take too long. But we aren't in any hurry about this. When you consider the maturities of the outstanding issues of state and local bonds, in the thirty or forty years that have been required before all of those will be refunded into taxable issues, there is really plenty of time, and all of the figures that all of us have ever used or compiled or guessed at with respect to the gains and losses involve a generation over which the thing would be worked out. There is lots of time for that.

It is true that a certain amendment to the Constitution has been kicking around the halls of the state legislatures for quite a number of years. It is also true that some other amendments—notably the one which repealed the "noble experiment" — went through as if

they had been greased. It took only a few months to put that through the requisite number of states.

Nobody has ever shown why, if this is a matter of such transcendant importance and urgency and significance to so many people, we wouldn't get 36 or 37 legislatures to pass it inside of 12 to 15 months, just as soon as you can get them together. If we were to believe all that we were told about the crying evil that is presented here, certainly the legislatures of at least thirty-six states would go into action immediately and ratify any sensible resolution that was put to them.

I suspect there is another reason for not wanting to approach it by the method of constitutional amendment. That is the plain knowledge that you never could get thirty-six state legislatures to ratify any such amendment. Consequently, it has to be dealt with by a stronger armed method than the orderly process of constitutional change, which the organic law of the land itself provides.

I think that is about all I need to say, Mr. Chairman.

Chairman Cushing: I think we are indebted to Professor Lutz for a very good analysis. Has anyone anything further to contribute? We would be glad to hear from him.

I am asked to suggest that copies of Mr. Epstein's paper are on the table here at the right, and one of the other papers, Mr. Kades' paper, is in some quantity for distribution out at the desk. There are several hundred copies.

If there is nothing further, and no more announcements, I will declare the session adjourned.

(The meeting was thereupon adjourned, at 9:30 o'clock p. m.)

SIXTH SESSION

MONDAY, OCTOBER 13, 7:30 P. M.

ROUND TABLE CONFERENCE

Spanish Room, Lowry Hotel

Norman MacDonald, presiding.

(Presented below are the full texts of all the papers delivered by the participants on this program, exclusive of the extemporaneous remarks of the chairman.—EDITOR.)

WHAT CITIES AND STATES SHOULD BE DOING NOW TO PREPARE FOR POST-WAR PROBLEMS

CARTER W. ATKINS

Director, Governmental Research Institute, Inc., Hartford, Connecticut

Preparedness for our national defense is the primary order of the day, but by its very nature it brings with forceful emphasis the demand for a second line of defense—preparedness for the day when it shall end. War defense activity on its present scale must end and every thinking person must realize that another period of critical economic and fiscal problems is in the offing.

The danger signs are screaming at citizens and public officials to heed the warning—put our fiscal and administrative house in order and bring the vehicles of non-defense governmental spending under control for the post-war shock. Failure to prepare for the post-war period may be as disastrous to our internal safety as failure to prepare for national defense would be disastrous to our national safety.

Indifference to the fact that cessation of war defense activities will likely throw upon government greater burdens than ever before experienced is but to risk breakdown of our national economy, fiscal collapse and loss of our democratic system of government. The severity of the strain may not be forecast but the severity of its effect will be measured by the extent to which our state and local governments are prepared to meet it.

If there is any doubt as to the serious aspects of this problem, let us look at just a few of the more important considerations squarely in the face.

Municipal governments and states, too, for that matter, went into the last depression largely unprepared for that which was to come. They found themselves unable to cope with the relief and unemployment problem and they cried to the federal government for aid. Many municipalities found it difficult, if not impossible, to raise sufficient tax revenues to meet their debt obligations. In fact, in some instances the debt of the local governments was so high that during the lean years cities, both large and small, were shaken to the very roots of their fiscal foundations. Many of them are still groggy from the experience of the last ten years and we still have the all too frequent and deplorable practice of bond refunding during current fiscal periods. One may well ask if debt requirements cannot be met now, when do we expect that they can ever be paid?

State and local debts are tending to increase and the estimated total is now above what it was when the last depression came. It is inexcusable that we face the next post-war period with a millstone of debt which will sink our cities in the mire of refunding and default. Wise and sound procedures dictate that steps be taken now to reduce these debts as rapidly as is humanly possible.

There are indications, too, that the cost of state and local government is tending to increase. Defense activities, producing higher wages, increased commodity costs, and inflationary spending, are reaching into the field of government operations creating budgetary problems which will grow in magnitude unless definitely controlled. Governments are facing employe demands for salary and wage increases and Federal W.P.A. officials are planning higher W.P.A. wages and more spending.

At the time of the last depression there were less than five millions of governmental employes and almost no form of governmental aid or assistance was extended to individuals.

Now reliable estimates show that the number of governmental employes is approaching five and one-half millions. In addition, approximately five and one-half millions of persons or families are receiving public assistance in some form, nearly one and one-half millions are receiving social insurance and unemployment compensation, hundreds of thousands are employed on federal construction projects, and uncounted numbers are receiving state and municipal pensions, war veterans' pensions and farm crop subsidy payments. Multiplied to individuals, probably thirty to thirty-five millions of persons now look to government for all or a part of their income or subsistence. This is not to debate governmental aid but to show by comparison where we start from when the next period of widespread unemployment occurs.

Our system of taxation has compelled our local governments to rely upon a single source of revenue, namely, the property tax, for almost three-fourths of their operating income. Yet, we find that

throughout the country public officials insist upon imposing upon that all-important and vital source of governmental income inequitable, unscientific assessing methods which tend to depreciate values and discourage ownership. Likewise, the zoning and planning functions of government have all too frequently been indifferently or politically administered to the detriment of their potential values as an aid to the stabilization or enhancement of real property values.

Such conditions should no longer be tolerated. We should be doing everything in our power to stabilize and conserve the values in real property which constitutes the most important resource for the operation of local government.

This post-war preparedness which we should seek can neither be accomplished nor carried out successfully without good administrative organization, competent personnel and the utilization of efficient systems and methods in public service.

Better charters and constitutions are needed. If our charters and state constitutions retain old, antiquated and cumbersome systems and methods, and functions no longer useful, let us change them. We say that we will fight to preserve our democratic system but we shall not preserve it unless we lay aside personal and political prejudices and adopt every needed device to make it work.

It seems apparent, therefore, that we have a real job of home defense and that we must prepare to defend our system of government and conserve our fiscal resources while we can. The program of action calls for the united effort of every citizen agency in the field of government, every thinking citizen and every public official.

We should pay off all maturing bonds and reduce the state and municipal debt as rapidly as possible in order to build a backlog of reserve borrowing capacity for the day when it will be vitally needed.

We should postpone all capital improvements which are not vitally needed so as to avoid the present high cost of labor and materials and conflict with war defense demands.

We should set up in each municipality and state a long-range capital improvement program of useful projects for the day when government must again take up the slack of private unemployment.

We should utilize every available means of reducing the operating cost of the state and local governments so as to ease the burden of the increased federal taxing program and conserve our local tax-paying resources.

We should revise city charters and state constitutions if necessary to provide more efficient and more workable administrative structures to eliminate duplicating, overlapping functions and provide for proper centralized administrative authority.

We should take steps to improve state and local tax systems and fiscal relationships, and above all, municipalities should move

promptly to adopt a sound equitable system of real property assessment and taxation.

We should take steps now to recast the system of emergency relief and W.P.A. administration and spending. The demands upon this activity are reaching new lows and this is the time to consider changes for the better. When the new load comes on it will be too late.

Some hopeful signs are already on the horizon. Leaders in the field of government and public administration are pointing to the necessity of taking steps to get ready for that which is to come.

The director of the United States budget has suggested that state and local governments postpone all public works which are not urgent and thus retain such improvements for the day when they can be more effectively utilized for unemployment relief.

The postmaster general recently urged that the department's bureaus be efficiently and economically conducted to provide a "cushion for the decline in postal revenues that is certain to be felt" when the present emergency ends.

The mayor of New York City has insisted that the capital budget for the coming year shall contain no new capital improvements.

The finance committee of the United States Senate has called upon the director of the budget to submit revised estimates showing how the current budget may be reduced by one, one and one-half, and two billions of dollars. One wonders how sincere a Congress may be in matters of economy when at the same time it introduces pork-barrel legislation embodying appropriations of nearly three-quarters of a billion dollars. That bill has been characterized by Senator Clark, of Missouri, as "the most colossal pork-barrel proposition in history," and "not only pork, but foul and putrid pork."

This post-war emergency which confronts us calls for action. It requires united action, and it must begin promptly. The lessons of the last ten years are here to be learned and heeded. May we look back a few years hence with the satisfaction of knowing that a democratic people can unite for the preservation of their internal defense as well as for their national defense.

WAR'S CHALLENGE TO CITIZEN CONCERN WITH GOVERNMENT

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Much of the discussion of the present war centers around the question as to whether or not we should take a more active part in that struggle. This is, in all truth, a very vital question, but one which we may leave, for the moment, to the isolationists, the interventionists, and the Gallup Poll.

Regardless of our party attachments, or our sympathies in this war, I trust that we can agree upon certain fundamental assumptions, namely: (1) That the war is world-wide in its scope and consequences; (2) that we may, whether we as individuals wish it or not, become more actively involved in it; (3) that we are, whether rightly or wrongly, embarked upon a defense program which will impose many of the conditions of war upon us; and (4) that, whether we become more actively engaged or not, the end of the war will find us confronted by serious domestic problems that will clamor most insistently for action by our citizens and our government.

It is a truism to say that democracy presents a perpetual challenge to its citizens. Totalitarian governments demand little more from their people than obedience, but democracy requires active participation in the governmental process. The *Fuehrer* and his satellites may do all the thinking for their nation, but democracy demands, beyond all other forms of government, an intelligent, informed, active, public-spirited citizenry. If this is a common-place observation, I can only say that it is one which is worthy of reiteration.

Even in times of peace and prosperity, the problems of a democracy are sufficient to call forth the best efforts of the citizen, if he is to keep his government from the pitfalls of extravagance, corruption, and bureaucracy—evils that almost certainly accompany indifference and smug complacency on his part. In time of war or other great national emergency, however, the challenge is a far more urgent one, and the consequences of failure to meet it intelligently are much more serious.

If the citizen is to respond intelligently to the problems now confronting him, he must have a clear picture of those problems. At the risk of treading upon controversial ground, I venture to suggest some of the most vital and most immediate of these problems, though not necessarily in the order of their importance: (1) The threat of foreign aggression; (2) the threat to our political institutions resulting from the economic and social cleavages of our people; (3) the threat to our economic and monetary systems inherent in long-continued deficits in our public treasuries and the profiteering instincts of many of our people; and (4) the threat of moral and physical degeneration of our people, through indulgence, soft living, and general repudiation of the concept that one deserves only that which he earns in the sweat of his brow.

Whether or not any foreign power or combination of powers seriously contemplates an attack upon the territory of the United States, we cannot say with certainty, but we cannot afford to ignore the possibility of such an attack. It must be obvious that our tremendous resources offer an ever-present temptation to less fortunate but more militant nations. Therefore, the need for defense cannot be overlooked.

The tradition of democracy is strong in America, and we are justified in the belief that our institutions cannot be easily overturned. Nevertheless, we cannot safely rest on the facile assumption that "It can't happen here." Social and economic cleavages and class antagonisms which we formerly associated only with the old world, have made their unmistakable appearance among us. Their obvious intensification in recent years has given rise to new social doctrines that cannot be ignored.

Our nation is blessed with abundant natural resources, and with a people adept in exploiting them. Therefore, it may be that we are capable of withstanding greater economic stresses and strains than less fortunate lands. Yet, we must recognize that our national debt is reaching alarming proportions, that the tremendous annual deficits cannot continue indefinitely without resulting in some species of repudiation, and that the whole economic structure is further threatened by the pyramiding of wages and prices, which already suggest the possibilities of an uncontrolled inflation.

Alarmists of every generation have lamented the callowness and the irresponsibility of youth, and have feared the moral and physical degeneration of the race. Much of this fear, we know, has been groundless. Nevertheless, we must not dismiss the suggestion of deterioration so lightly. The very comfort and security for which we have struggled may have a debilitating effect upon those who enjoy it without having to struggle for it. We have made great advances in education, public health, and the conquest of disease, and the importance of these things should not be minimized, but the fact that an ever-increasing proportion of our people are growing to maturity without ever having faced the necessity of strenuous physical exertion, or ever having to rely upon their own efforts or ingenuity for their existence, can hardly fail to have a softening effect upon their bodies and their moral fiber.

History suggests that when a nation is faced by a great crisis, it must meet that crisis with some kind of positive action. To do nothing is fatal, and the government which does nothing forfeits its right to govern. If one form of government proves itself either indifferent or inadequate to the demands made upon it, it will probably be supplanted by some other form. The citizens of democratic countries must face this brutal fact. Throughout Europe, we now see the sad spectacle of one country after another having succumbed to dictatorship simply because its previous form of government failed in a crisis. Thus, our government and our citizens must not fail in this crisis if they desire to preserve our representative institutions.

Perhaps the first question which the citizen has to decide for himself is whether he wishes to have his problems solved through a democratic social organization, of which he is an active member, or

whether he prefers to confess his incompetence and concede the power of government to an irresponsible autocrat. By doing the latter, he would free himself of the responsibility of citizenship. No longer would he have the responsibility of choosing leaders and formulating policies. At the same time, he would lose many of the inestimable privileges which he now enjoys. No longer would his rulers have to consult his wishes or his interests in anything they do. No longer would he have any assurance of protection in his home, his family, and his goods, or his right to engage in business, agriculture or the professions. No longer would he be free to join the church, the party, the club, or the fraternal organization of his choice.

The burdens of citizenship in a democracy are admittedly heavy, and their accompanying problems are often confusing, even to the well informed. It is not surprising, therefore, that the bewildered citizen sometimes feels that he would like to be relieved of this responsibility, and let his rulers decide all troublesome questions as they see fit. This, however, is the surrender of the slave, who feels unable to cope with life as a free man, and is willing, therefore, to accept the lowest status in society in return for the pittance which he receives in the way of physical necessities and the promise of personal security—a promise which we now know to be unreliable at its best, and deliberate deception at its worst.

It is easy to call upon the American citizen to defend his country and his institutions. In the abstract, we may count upon his willingness to defend them. It is not so easy, however, to outline a specific program for him, and it is less easy, perhaps, for him to follow a realistic program when it is offered to him. Such a program calls for sacrifice which he is not always prepared to make.

I have no doubt that we can defend our country from direct foreign aggression if we care to devote the necessary time, energy, and resources to problems of defense. It must be recognized, however, that adequate defense will ultimately require far more than a numerous army and vast quantities of modern armaments—necessary as these things may be. We must, above all, have the will to defend, and must have the moral and physical stamina to withstand whatever ordeals may come.

Historians may debate whether the fall of the Roman Empire was caused by rats, mosquitoes, the failure of the hay crop, or the overwhelming numbers of barbarians pressing against its borders. The ultimate cause, however, must be sought in the deterioration of Roman manhood and Roman character. The people had forsaken their vigorous republican institutions and embraced a species of theocratic despotism. While the rich turned to gluttony and lavish display, the masses turned to sloth and idleness, depending upon

public largess for sustenance and entertainment, while the work was done by slaves and the fighting by foreign mercenaries.

In brief, Rome seems to have been finally destroyed because her people had been so far undermined that they lacked the strength and the will to govern their vast territories and to resist the invading hordes. Modern civilizations, including our own, may conceivably be undermined in the same way. France now stands as the latest tragic example of a great nation, with a proud past and a rich culture, which has fallen to low estate in part because of the pursuit of ease and contentment at the same time that its people cultivated an attitude of cynicism and irresponsibility toward their obligations of citizenship.

I would not suggest that physical and moral degeneration in America have reached an advanced stage, but for at least two decades it seems to me that we have pursued no ideal more lofty or fundamental than the spreading of harder and harder butter on softer and softer bread.

Our ancestors fought for human liberty, but they saw in that liberty the right to work, to achieve, to develop one's personality, and to improve one's station in life. If we use that liberty only for the purpose of cultivating our favorite luxuries and vices, for indulging the whims of our children, and for justifying our refusal to do unpleasant tasks or to face unpleasant facts, then the health will have gone out of our society, and American democracy will appear to historians of the future as just another noble experiment that failed.

Our people have been foremost in the development both of labor-saving devices, and of humanitarian social philosophies, but we have not yet shown ourselves capable of making the most intelligent use of either one. Our mechanical ingenuity has too often resulted in a striving for false standards of living, beyond our economic means, while our humanitarian sentiments have been used not merely to alleviate the sufferings of the unfortunate and the destitute, but to justify the maintenance of a large part of our people in idleness, at public expense, and to relieve the individual from all responsibility for his own welfare and that of his family.

Lest this be thought to be a reactionary doctrine, and a mere insistence upon a return to " the good old days ", or some non-existent golden age of the past, let me say that I recognize that we cannot turn the clock back. For good or ill, we have recognized the responsibility of government for at least a minimum degree of social security. For social as well as political reasons, government cannot divest itself of the responsibility which it has assumed, and I am not disposed to argue that it should do so. On the other hand, I am not prepared to accept the doctrine that the government owes every person in the society a living whether he does anything to earn it or not.

Among the most serious of the domestic questions which we shall have to face at the end of the war is that of our national debt. That debt now stands at something like fifty-five billions of dollars. It is freely predicted that it will reach seventy-five billions in 1943, and if the present crisis is an extended one, a debt of one hundred billions or more is not at all improbable.

The growth of this debt is serious not only in itself but also because of a new national psychology which it seems to have engendered. It is now widely believed that debt can be used as a substitute for growth, progress and strength. This belief is at once an evidence of weakness among our people, and a serious threat to American democracy. Debt was once regarded as evidence of failure and collapse. Among our ancestors, the chronic debtor and the bankrupt were despised. Today, debt, both public and private, has not only been accepted as the normal thing, but seems actually to have become the hall-mark of success.

I would not venture to predict how large this debt must grow before the weight of it will crush our economic structure. This, perhaps, will depend as much upon political and social factors as upon purely economic ones. It must be obvious, however, that no government can live perpetually beyond its income without becoming insolvent. If this is true, we are faced with two alternatives: (1) balance the national budget, and begin the retirement of this huge debt, or (2) repudiate the debt, either in whole or in part, by direct cancellation or by inflation and payment in a greatly depreciated currency.

Outright repudiation of the government's obligations is, it seems to me, unthinkable to an honorable people. Aside from the injustice to the citizens who have been persuaded and cajoled to invest in government bonds, such action would have an extremely serious effect upon our economic structure. It would bring about a species of redistribution of wealth, but the redistribution would have no relation to either the needs or the virtues of those involved in it, or affected by it.

If repudiation is not to be considered, then we must gird ourselves for the struggle of meeting our obligations—and it will involve both a political and an economic struggle such as we have seldom faced. America is a land of vast resources. Our national wealth is estimated at something over three hundred billions of dollars, and the national income now approaches eighty billions a year. Beyond this, our capacity to produce wealth is prodigious. Nevertheless, we simply cannot live indefinitely like the wastrel heirs of a great fortune without courting disaster. Of all the factors which produced dictatorship in Italy and Germany, none is more obvious than the growth of national despair in these two countries—a despair which was, in each case based partly upon the impossible burden of debt.

I personally have little doubt that we are capable of balancing our budget and retiring this debt. If we are to do so, however, it will require a greater determination and a greater willingness to make sacrifices than we have yet evinced. Furthermore, it will require a change in our national psychology. To our ancestors, a great public debt was abhorrent. To many of the present generation, it is a symbol of achievement, or at least, a matter of little concern. Perhaps we shall yet boast of our growing national debt as we do of increasing population, and the growth of public education.

We balk at the harsh discipline of totalitarianism, and recoil from the blind obedience required by dictatorship, but if we are to preserve our institutions we must exhibit a greater capacity for self-discipline. In brief, we must forego some of the services and luxuries which we have been demanding of our government, and we must be willing to pay the taxes necessary to defray the cost of the things which we still demand.

The burden of taxation is already heavy. Perhaps we get value received for the taxes we pay. Nevertheless, there is a law of diminishing returns, and a limit beyond which taxes cannot go without crushing us all. For the present, of course, we must accept such taxes as are necessary to stabilize our economy, but we must realize that excessive taxation, in addition to imposing real hardships upon the individual citizen who pays, drains away billions of dollars annually which might profitably be left in the hands of the producer for further developing the country's resources and productive energies.

We must, I suppose, see the defense program through without complaint. It is not unreasonable, however, to expect a drastic reduction of non-defense spending. Specifically, I feel that we could now dispense with the expenditures of a frankly "pump-priming" character, since the billions poured into defense serve a similar purpose. Ultimately, it must be clear that a balanced budget assumes both a reduction of expenditure and an increase in taxes, and both will be politically difficult. One of the most serious weaknesses of our system in recent years seems to be that the government has had to respond to the demands of two different publics, with interests that are diametrically opposed to each other. One public has demanded greater and greater government expenditures, while the other has resisted the increases in taxation which the greater expenditures demanded. Both publics have been strong enough to have their way.

Standing alone, either of these two policies may be understandable, or even defensible, but the two combined become an obvious absurdity. Our people must yet be made to realize that the government is their servant, and must do their bidding, but that it is not a supernatural thing, and cannot, in the long run, spend more money

than they themselves provide. There is no royal road to a balanced budget now, any more than there was a royal road to geometry in the time of Euclid. To paraphrase the inspiring words of Winston Churchill, it is only through blood, sweat, toil and tears that our patrimony can be saved.

Many of my remarks have, at least by inclination, been critical of the policies of our national government, but I would not be understood to place all the blame in Washington. Some of it must be sought in our state capitols, our county court houses, our city halls, and in the great body of our citizens. All too often, our national government has shouldered new burdens because our state and local governments were unable or unwilling to provide the services which their people demanded, sometimes joining in the plea for federal aid. Much of this federal aid may have been necessary and desirable, but it has given rise to a lamentable competition between sections, states, and localities of our country—a competition not in frugality or civic virtue, but merely one of "getting theirs" from the federal treasury. Each state watches with jealous eyes every allotment of federal funds, for fear that some other state or section will be favored. This acceptance and extension of the old familiar pork-barrel principle is illustrated by the remark attributed to one congressman to the effect that "If I see any other state get a ham, I'm going to demand a whole hog for my state."

Thus, each state embarks upon the policy of getting all it possibly can from the federal treasury, on the theory that "It's there. If we don't get it, somebody else will." Unfortunately, this spirit of competition extends to counties and communities within the states, and to their citizens. They are encouraged to apply for state and federal funds for projects which they would never undertake themselves, because of the feeling that some other community will get the money if they don't.

I have been speaking of the war's challenge to the citizen, but the challenge is, in fact, directed equally at the citizen and his public officials. Even in a democracy, there must be leaders, and the leaders must point the way, but in a system such as ours, no government can pursue a consistent and constructive policy unless a preponderance of its citizens demand and support such a policy. At the same time, the government cannot reasonably expect the citizen to make greater and greater sacrifices, unless it is willing to do its part.

If we are to be honest, we must admit that our government, from the town hall to the national capitol, have not always been conducted in such a manner as to merit the confidence and cooperation of our people. In my state, for example, the tax laws have, at times, been so administered as to result in widespread tax evasion and a very unfair distribution of the tax burden. The citizen is aware of these injustices, or at lest suspects them, and he frequently uses them as

an excuse to evade his taxes and his other obligations of citizenship. It is well known that many persons who are otherwise honest and public-spirited will conceal their property from the tax assessor if they can. This is readily admitted by many taxpayers, who defend the practice by asserting that everybody else is doing the same thing. I have found, however, that most of these people would be willing to pay their taxes if they were convinced that others are being required to pay in the same proportion. This situation, then, presents a most direct challenge to those who make and administer our laws.

Whether the American people will respond effectively to their problems in this crisis or not, I cannot say. I have no doubt of our ability to respond. Certainly we have all the basic materials for doing so—a bountiful land, an intelligent and progressive people, and diminishing but still formidable ocean barriers against the disturbances of the old world. My only fear arises from the fact that we have been lulled into a false sense of security and national well-being, and that we may not realize our danger, or take the necessary steps to avert it, until it is too late. If we do not respond effectively, the tragedy will be not merely that our noble experiment has failed, but that it failed after success was already within its grasp.

WAR'S CHALLENGE TO CITIZEN CONCERN WITH GOVERNMENT

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Leaving entirely to one side the question of whether we are to become engaged in a "shooting war," the tremendous scale of our present defense effort raises for the American people some challenging and perplexing problems.

We are faced with a fact of far-reaching importance. Overnight the federal government has suddenly stepped into the rôle where it is complete master of the nation's economic destiny. What the future will be, it alone will determine. We are caught in the grip of great titanic forces. Where these forces are carrying us, we do not know. What we do know is the uncertainty of our present position and that we have neither chart nor compass for the course upon which we have embarked.

But Mr. Hitler alone is not the only cause of our existing dangers. War merely intensifies and brings to culmination certain trends. War or preparation for defense superimposed upon government and the economic structure bring these long-time trends into sharp focus. Under the pressure of colossal war requirements stresses and strains which have been steadily developing now become clear and suddenly acute.

We are sharply brought up to the unhappy realization that already we have strained the fabric of democracy. At the very time we need its full strength, we find the democratic processes pulling at the seams.

We have turned to the state to find solutions for all kinds of problems that, we see now, might have been better solved had we been more self-reliant, more determined to meet issues squarely, face to face, rather than to borrow from our children's inheritance.

We have leaned on the state so heavily that we are a little frightened at the very size the state has developed. We have done the very thing our fathers sought to avoid. We have created a great Frankenstein of centralized political power which casts its shadow over every citizen and over every undertaking of whatever kind.

The basic trend straining the democratic process is the steadily accelerating movement in the past few decades of shifting responsibility to a distant government. Whatever its cause, its effect upon the individual's active expression in democracy has been devastating.

Shifting of responsibility has brought government by remote control. It has accelerated centralized government. With this concentration of authority and expansion of services there has come great power—power of almost unbelievable magnitude. The centralized state has emerged. The very concept of government has been subtly changed. We see democracy and republican institutions either struck down or on the defensive throughout the world. Instead of a society made up of free men, each free to achieve his ambition in his own way, unhampered by the state, we see emerging the fetters of a state-controlled economy. We are moving from an incentive to a state society—from an industrial society of production, competitively geared, with gain as the incentive, to a state-controlled society. Throughout the world today this takes on various manifestations. We may sugarcoat what we are doing, we may even affix pretty labels to the process, but the stark fact is—a silent, non-violent revolution has taken place. However this expresses itself, whether with benevolent purpose or evil design, the fact remains that the state has become all-powerful. Those who look to the state for the answer to all problems—the statists—are in the saddle.

This is not to imply that all the actors on the scene necessarily willed changes to go so far. Though statists all over the world have worshipped the state, what some statists have not realized is that the state which can control others cannot always control itself. This may be a curious phenomenon, but state control feeds on itself. It has powerful forces within itself—and decreasing resistances from without—which steadily further growth and expansion.

Once started, state control does not say "let natural forces express themselves." It does not go back to the industrial society. Every problem must be met by some new control.

Thus we, and statists, willy-nilly, are caught in a stream of forces which constantly elevates the state until we reach the ultimate of individuals existing for the state—and not the state for the individuals.

We are suddenly becoming aware that we cannot always control forces once we set them in motion. For example, we have yet to see whether the state can control inflation. We have yet to see whether the state can control spending.

During the latter twenties there was criticism over the apparent inability to control the upward spiral. Forces were in motion which appeared beyond our ability to control. Suddenly we were over the precipice in the wild downward plunge of a Black Friday. It may not be a Friday this time, but can we stop short of some Black Monday?

Perhaps there may be a further parallel with the twenties. You may recall how those who expressed some apprehension over the rapid upward spiral were denounced as pessimists, dissenters and obstructionists. Yet we dashed madly on. We were in a new era. Today, too, we have the new era boys. Just as then — when the public had its fingers crossed—when the public felt that all did not seem well but desperately hoped it would come out all right, there again appears to be an underlying public feeling that all is not well.

Today we have a new crop of blue-sky boys — who tell us don't worry about spending—don't worry about the public debt—the public debt is different from private debt. Occasionally we hear some argue that not only should we continue to go in debt but that there are dangers in paying the public debt. Those of us who were taught that there were eternal verities cannot believe that through some mystical process we can avoid the consequences of financial indiscretions whether these be personal or those of the state.

The SEC fortunately deals promptly and vigorously with the old-time blue-sky salesman—unfortunately, it does not reach the modern blue-sky boys.

With the emergence of the state has come a new political machine. This machine is like the old just as a modern bomber is like the Wright brothers' first airplane at Kitty Hawk—but also it is just as different. It is like the old in that it must still have a motor—and that motor is patronage. Only now it has many more cylinders and soars higher. Its swift, smooth flight is far superior to the clumsy, uncertain fluttering of the early machine.

By slow, gradual steps unperceived by many we have come into a new era of power politics. Today we have streamlined politics upon a basis which has no comparison with the past century or with the early days of this century.

We cannot blink at the fact that modern streamlined power politics is fueled by a steady flow of public funds in great volume. Whether

power politics brought on vast public spending or public spending made possible the era of power politics is perhaps to raise the question of which came first, the hen or the egg. The observable fact is that both exist side by side.

No useful purpose would be served in citing the extent of our public spending and debt as there is a high rate of obsolescence in these figures. Like the lawyer who confined his study of the law to the statutes and suddenly found the legislature presently had repealed all he knew, so we find the rapid expansion quickly making our knowledge out of date. If we comprehend the figures at all, we are lost in their enormity. Those who are not totally oblivious to the figures and their implications are, I am afraid, punch-drunk.

At the very time when we need to draw upon the nation's utmost strength we find that strength depleted by a long economic illness from which we have not yet made a complete recovery. We approach a great and vital turning point in our history, not with sureness and confidence, but with doubts and misgivings.

Now this is a completely new experience for the American people. We are suddenly confronted with the fact that we have too long been prodigal with our vast resources, and we have the prodigal's twinge of conscience on a sad and sober morning—after awakening. We have been prodigal with billions, and now we see those billions that have been spent menacing the future in the form of a $100 billion or $200 billion national debt.

Whatever the current up-to-date figure on public spending and debt is, the vital over-all pressing issue is, "what is going to be done about it?" So far, there has been little to indicate that we are to slow down as we hurtle through space at a rate that can be counted only in astronomical billions. We do not deny the necessities of defense—but even there we can insist on getting values without waste. We understand that we cannot have butter and guns too. We accept it. But the public will not accept oleomargarine if government bureaucracy is to have fat creamery butter. Government must lead the way in sacrifices in non-defense items. The challenge to the state and to power politics is: Can it reverse the trend, quickly and broadly enough to save us from what the Secretary of the Treasury says "is a distant threat no longer"? The state is in control. Can it control the forces it has set in motion? That is its responsibility; it cannot be shifted.

Some feel we are over the brink already. Others that we have only months in which to put our house in order. One of the few hopeful signs is the action of Congress on Senator Byrd's proposals calling on the Budget Director for specific economy suggestions of $1 to $2 billion; the other calling for a joint Congressional Committee on Economy. These may be frail reeds but they give us some hope, even as we sweep on in the crest of a swollen flood.

There are six powerful basic resistances opposing any change in the volume of spending.

First, spending is the easy course to pursue.

Second, power politics requires spending—and on a large scale—to sustain itself. Internal forces within our modern political machine thrive upon spending. Old-fashioned patronage has been replaced by a streamlined super vehicle. Granting the sincerity of the public officials within the governmental machinery, we must nevertheless note that internal conflicts and internal pressures result in more, and not less, spending.

Third, vast segments of the voting population have a direct financial interest in retaining the state's return to them. This is swelled by the sizeable groups with less direct, though important, personal interests.

Fourth, shifting of responsibility has brought with it the vicious practice of looking to this distant government for funds. Municipalities look to the state, and the states join local governments in a tin-cup parade to Washington. Thus, we have government by hand-out. This "free money" philosophy has accentuated fiscal irresponsibility at all levels of government. It has tended to make the average citizen more and more indifferent to government waste and inefficiency. It has fostered a spending philosophy, not only among our public officials, but among the mass of citizens.

A fifth powerful factor is the pressure groups. These have grown with the expansion of government. They thrive in the trend toward centralized government. They flourish, wax fat and powerful, under government by remote control. The farther government is removed from the citizen, the less articulate he becomes. In the absence of clear expression of the public mind, the pressure groups are able to exert a greater influence as the legislator comes to depend upon the persuasive expression of minority groups.

Sixth, we have had a ten-year educational course in spending. Through a decade the citizen and his political representatives have been taught that public spending and public borrowing are not an evil, but a necessary good. The easy-spending habits constitute a real obstacle to reversal of the trend.

These are powerful forces to overcome. The prospect is not bright.

Against this, what have we?

In a practical way, the cost of our public financial indiscretions begins to come home. One of the most hopeful developments is the recent expansion in the number of citizens who are being called upon directly to pay for government costs. Many who heretofore have not felt these costs in any observable way now suddenly are rudely awakened by the impact on their own pocketbooks.

A further hopeful sign is the appearance of resistance to the pressure groups as citizens organize themselves. Perhaps it would be better if there were no pressure groups. However, so long as they do exist on one side there is need for resistance on the other—for unopposed they unbalance democracy.

Third, and the most basic, is what I would like to call the application of our social intelligence to high moral purpose. During the past two decades there has been a lack of a spiritual sense, which has been a major contributing factor to the forces now predominating in the world.

If, and I believe we can, if we can restore our faith in the dignity of the individual man, if we can remember that the state exists to serve man and not man to serve the state—then there is some hope.

WAR'S CHALLENGE TO CITIZEN CONCERN WITH GOVERNMENT

ROBERT M. GOODRICH
Director, Bureau of Governmental Research
Providence, R. I.

With world conditions as they are today, it is difficult to assess accurately the essential realities which condition our immediate tasks. Those of us who work with citizen organizations sense in the present confused circumstances, not only increasing obstacles to a sustained concentration of interest on public affairs, but we are even more concerned with the gravity of what may happen if the right of citizens to participate in the affairs of government is permitted to lapse.

It is not at all unreasonable to suggest the possibility that our way of life hangs on a more tenuous balance than ever before. Not only are present conditions dangerously volatile under the threats of enemies from abroad, but ten years of bitter political and social friction within our own ranks has left wounds which even under favorable circumstances could not quickly be mended.

The plight of those countries which have fallen under the yoke of totalitarian tyranny, however, has served to make clear the values and advantages of our system of government in spite of its faults. Force of events has brought home to us a more acute realization that freedom is a precious possession, and that the exercise of the democratic process involves something more than the privilege of free speech and the right to cast a ballot on election day. To help vitalize this democracy by providing the individual citizen with an opportunity to make his voice heard and his influence felt, is a responsibility resting on citizen agencies that must not lightly be regarded.

As we review the past, it appears that until comparatively recently the pattern of citizen participation in government was relatively a simple matter. The large nation-wide and international corporations found their primary interest in Washington. The railroads, the utilities, and occasionally trade and professional groups found their chief occupation with the state legislatures, while the real estate owner was left to wage the fight in the city hall and county court house. In short, the concern which most citizens had with government could, for the most part, be discharged through self-interest groups working in exclusive fields.

The period since 1930 has given rise to an entirely new set of conditions. Local governments confronted with greatly increased expenditures and curtailed tax resources, turned to the states for help, with the result that a tide which had been flowing for nearly half a century toward greater local autonomy was reversed almost over-night. Following the action of the states, the federal government soon entered the relief and other fields, and entirely new relationships between cities, states, and the federal government were set up with the result that the three primary levels of government no longer operate essentially on specific economic groups.

Today the man on relief in his own way, has as vital a stake in the policies and determinations of his government in Washington as the head of an industrial corporation; and it scarcely is necessary to note that state and local taxes are directly affected by federal taxation, and that federal policies in matters of housing, health, highways, schools, and other services, today exert a direct influence on the character of state and local governments and the amount of the state and local tax burdens.

These new conditions and relationships, coupled with the magnitude of current appropriation measures, not only have created a condition of serious public confusion, but it is perfectly apparent that no longer can influence be brought to bear at one level of government, or by a single economic interest, without anticipating the reaction which may be set up at a different level, or on some other interest. To determine how these reactions operate; to be able to see clearly the entire picture; and to consider broadly what is most likely to result in the maximum public benefit, is a task therefore which calls for a kind of unprejudiced critical appraisal which transcends the limits of any partisan or self-interest group.

It would seem reasonable to conclude therefore that if public opinion is to continue to play its part in the formulation of governmental policies, adequate and reliable facts must be made available, and the machinery for obtaining such facts must be predicated on a broad public interest.

At the present time there are perhaps not more than five organized sources from which might emanate the kind of dispassionate

critical analysis which current problems require. These are the major political parties, the press, national organizations, the educational institutions, and citizen organizations. It is somewhat unrealistic to expect political parties to develop unprejudiced facts. Parties have a great need for facts, and can serve a useful purpose through intelligent criticism based on facts, but they scarcely may be regarded as a suitable source for the development of factual material. The press essentially is a reporter of news rather than a news maker, and while the editorial columns contribute greatly to the function of critical analysis, editorial writers as a rule have neither the time nor facilities to delve deeply into the kind of research which today's problems necessitate. Most of the national organizations reflect special interests, and unfortunately those that have a sufficiently broad point of view to be reliably unprejudiced, either have other primary interests, or are inadequately financed to carry on extensive fact-finding programs of the type under consideration. The colleges and universities are becoming increasingly articulate in the field of public affairs, and are producing a substantial amount of excellent research on a wide variety of subjects. Further development of this function may in time meet all requirements, but in the meantime an immediate need exists for work in the front-line trenches of critical analysis, and except for isolated instances this as yet is beyond the scope of most of the educational institutions.

There remains for consideration the potentialities and practicality of citizen organizations as effective media for producing the kind of information that current conditions and problems demand. Because such organizations are composed of and run by citizens, it is obvious that they occupy a most favorable position to respond to the needs of citizens. Because such organizations have no particular axe to grind, the results of their research can be made use of impartially by citizens, public officials, the press, political parties, self-interest groups or anyone else having need of factual information. Because their governing bodies can and should consist of responsible citizens, their loyalty is beyond challenge, and they can avoid suspicions of ulterior motives. And most important of all is the fact that because they must rely on contributions for their support, they must maintain the integrity of their work at a level which justifies public confidence or they cease to exist.

There has been in existence for many years in most of the larger cities and in several of the states, organizations which have occupied precisely this field in local and state affairs. On the whole, they have been eminently successful, and have contributed substantially to a better citizen understanding of public affairs, and to improvement in the administrative processes of government. There is every reason to believe that the same principles can be applied to the wider field with similar success.

At first thought it may seem that these small independent citizen organizations cannot possibly cope effectively with the complex and diffused problems with which citizens today are confronted. But with the realization that it is the effective functioning of the individual citizen that we are trying to preserve and revitalize, the conclusion seems inevitable that the most rational approach is through the translation of these problems into terms intimate enough, and small enough, to be understandable by the ordinary person.

To most citizens such matters as the excess profits tax, the agricultural conservation program or even the federal government's part in the W.P.A. program are problems with which they feel a vague concern, but of which they have little practical knowledge. When such matters are considered at the national level it is a simple matter to confound the public and even the Congress with nation-wide measures of the benefits or consequences resulting in remote areas and to unknown thousands. But if, for example, W.P.A. figures are broken down in such a manner as to show for a specific community exactly how many are employed on work projects, what these projects are, and precisely how much work is being performed, it is possible and reasonable to expect citizens to make an accurate appraisal of the real value of a publicly supported work program.

Budgets in which the vocabulary recognizes no coinage of less than half a billion dollars, coupled with the empiric formula that two-thirds of government expenditures should be paid for by current taxes, have served well to deaden the last remaining pains of intellectual tax consciousness in the ordinary citizen. Experience generally has demonstrated, however, that even the most complex problems can be solved, if we have the ingenuity to reduce the essential elements to terms of simple proportions, and the tax problem should be no exception to the rule.

Local citizen fact-finding organizations have demonstrated an ability to develop exact information on the cost of collecting a ton of refuse or maintaining a square foot of floor space in the city hall, but the opinion is ventured that not one of them ever inquired into the cost of operating the local federal buildings, or that more than a few of the services performed by the federal government in their community could correctly be described. Such inquiries, of course, have been outside the concern of most local organizations, but if the federal tax problem is to be simplified to terms of public understanding, and this applies particularly to the non-defense phase of the problem, it is logical and necessary that they broaden their activities by beginning to translate into terms of local service the expenditures of the national government.

Furthermore, it may be possible that a significant interpretation of our tax system can be devised if payments of federal, state, and local taxes can be related to the income, expenditures for supplies

and services, salaries and wages, etc., of each state or community. Pioneering studies in this direction already have been published, and with an improvement in method and a freer access to source material it may be that a real beginning can be made toward bringing an informed public opinion to bear on the tax question.

Other important present-day problems are less complex than the tax problem, and because factual information can more readily be obtained no unusual difficulty should be presented to the better qualified fact-finding organizations.

One such problem is the trend toward centralization of administrative control and the consequent subordination of local government. As was indicated previously, financial incapacity on the part of the local government apparently gave rise to this transfer of authority and responsibility. Such a step was convenient and easy to effect, but it is at least open to question whether this solution should be accepted as a permanent arrangement. If local governments had possessed adequate financial autonomy it is doubtful if this trend toward centralization would have developed, and question now arises of whether it might not be better to reverse the flow by granting to the local units greater financial resources. Such a step involves the affiliated questions of the value and effectiveness of grants-in-aid and state levied locally shared taxes, as well as the application of ingenuity in developing new revenue measures which are capable of fair and just local application.

Another broad problem of immediate concern is that of the relationship between the public and the public employee. Undoubtedly the public should serve as a model employer, but the relationship is unique in that the stoppage of public service is quite likely to result in irreparable damage to the community. The recent difficulties in several municipalities show that definite responsibilities must be established in this relationship, and a study of effective controls is an immediate necessity.

It is clear, of course, that forethought should be given to the problems of post-war adjustment, but it is the existing problems that are immediately important. The period that lies ahead should provide a favorable opportunity for correcting many of the mistakes which have been made in the emergency of the depression. It seems likely that local and state governments in particular, and to some extent the federal non-defense activities, will experience a more or less quiescent period during the war emergency. By utilizing this opportunity for the correction of faulty and unsound policies and practices, governments will be in a much better position to meet their responsibilities after the war than would be the case if present errors are permitted to compound.

It is certain that citizenship is confronted by an unprecedented challenge. We are participating, or at least rapidly approaching

actual participation, in a war to preserve our way of life. The methods which must be employed to preserve that way of life, inevitably run counter to the very kind of individual liberty we are trying to preserve. The need for unity of purpose and action prescribes and controls the limits of individual action.

To bridge the gap between necessary governmental controls and the proper discharge of the functions of citizenship, citizen organizations can serve a useful purpose. Such organizations properly may be regarded as responsible agencies for the effective operation of a proper citizen concern with governmental affairs under emerging conditions. Working closely with public officials and with an adequate understanding of the facts, citizen agencies may find themselves as the one effective mechanism for preserving the essence of our democratic institutions over a difficult period.

The responsibility for so conducting our activities that we may fill this position is grave. The hope of preserving our kind of democracy rests very largely on the ability of citizen organizations to keep citizen effort alive and effective. The simplicities of an earlier day have passed, and those of us who are engaged in the process of trying to make democracy work, must find a way to preserve a hope and a conviction that this way of life of ours has vitality, that it can be made efficient, and that it is the best system on earth for a free people.

WAR'S CHALLENGE TO CITIZEN CONCERN WITH GOVERNMENT

LESLIE M. GRAVLIN

State Commissioner of Administration, Minnesota

The greatest business in the world of a few years ago has been forced out of the big main tent and now is merely a sideshow. Government-as-usual, that is, the every-day, undramatic local, state and federal services performed at an annual cost of about 15 billions of dollars, has been supplanted as the largest business in the world by the dramatic defense expenditures, which, it is estimated, will total more than 100 billion dollars in the next three years.

Self-preservation is the compelling force back of these latter expenditures. There is no criticism that can be aimed at the purpose of these fabulous estimates nor the intensity with which defense is being furthered. There are, however, certain by-products of this effort that must be taken most seriously by those interested in every-day government—that is, governmental services that must be performed during normal as well as emergency periods.

The very lavishness of the defense plans staggers the imagination. Mentally, the public is inflated. It thinks of everything in terms

of bigness. The ability of those in governmental service is challenged to produce something bigger and better. Extravagance, even waste, in these supreme efforts is apparent, but is overlooked. The cry is for full speed ahead. A devil-may-care attitude so far as monetary acts are concerned pervades all. This attitude is enhanced by the fact that the piper isn't calling for his pay. The cost is being met wholly out of borrowed money. A recent tax bill raising income taxes and levies on consumption causes the taxpayer to raise his eyebrow, it is true. It doesn't, however, result in the taxpayers as a whole demanding that the tax spender, or rather borrowed-money spender, pull in his belt. Our financial picture is merely in the preliminary sketching stage. It doesn't cause the taxpayer to turn his eyes to the same picture elsewhere that has been brushed in. Consider Britain, where "it is practically impossible nowadays for even the richest man to have an annual income of more than 5,000 pounds, or $20,000." The implication of this to all is apparent. Possibly the old saw should be changed to "the rich get poorer, and the poor get poorer."

It is right that attention should be focused so largely upon national effort. All of us must recognize the necessity of preparing the nation adequately to protect itself from the mad forces now loose in the world. But let us not fail to be realistic about the effect upon the ordinary processes of government. We must not forget that the very basis upon which our national structure rests is democratic, local self-government. It would be tragic, indeed, if we permitted these foundations to be weakened or destroyed while fixing our minds on the larger job. Change is inevitable. With so much of the resources of the nation going into the defense effort, it is hardly conceivable that the usual activities of government can be carried on undiminished and uninterrupted. How to meet these changes, without decreasing too seriously our local governmental services or impairing their future effectiveness, is the great problem that faces us.

Indicative of the period of change we are in, is the relief problem. Overnight almost this problem has eased. In some areas with large defense orders the load has practically been eliminated. That is the picture today. But many aspects of it are changing rapidly. What will it be tomorrow? While increasing thousands of men are going into defense jobs in the countless plants and factories working on government orders, employers in many lines, unable to get materials without priorities, are being compelled to reduce their working forces. Some have had to cut down one-half, and not a few have had to close entirely. What effect is this going to have on the relief problem? Looking ahead still further, what are we going to do when this conflict is over and the defense plants come to a stop? What of the thousands of men who have been drawn from the farm to the city or from one state to another by the magic appeal of

defense jobs? We shall face problems then which will place tremendous burdens upon our governmental agencies and no doubt tax the resources of our people. Let us be realistic now, and begin to prepare for that day.

Newspaper headlines have prepared the public mind for some of the war's effects that are in store for us. But not until next March will our people really be aware of the full meaning of Uncle Sam's new tax program. That meaning will be no less real to state and local government.

In fields of taxation where both the federal and state governments exact their tribute, the states' yields are going to be greatly impaired. What every state experienced after the last federal increase in the beer tax will be repeated as a result of the higher federal tax on hard liquor. In Minnesota, when the federal beer tax was increased on July 1st, 1940, beer consumption decreased 20 per cent, and because the state rate remained unchanged we had a corresponding loss in beer tax receipts.

Minnesota's income tax law and the income tax laws of most states permit deduction of federal income tax payments from the taxpayer's income in arriving at the state tax liability. It must follow, therefore, that the doubling or tripling of federal personal income taxes will shrink the tax base for state purposes and lead to a reduction in state revenue unless the total national income is vastly expanded.

In one fell swoop the national government has practically ended the development of the income tax for state purposes. It has increased the middle and higher bracket rates radically and has reached down into the lower brackets where the states have refused to go. In any state with income tax rates which already are steep it will not be easy to recoup revenue losses by still higher rates.

By increasing or imposing new taxes on articles of various kinds, by increasing burdens of different types that fall upon business firms and individuals alike, the government has encroached farther and farther into the fields from which local and state governments must derive their revenue, and, in spite of all grants in aid, tended to increase rather than diminish burdens of local government. Cities and counties face the worst plight. Tied largely to the real estate tax to support their activities, the future for them looks bleak. Real estate taxes are confiscating property at an increasing rate in all our cities. Wherever officials of our cities look in a quest for new tax revenue, the long hand of the federal government or the state has reached before them.

On the revenue side of the budget—that part of the budget which it sometimes is convenient to forget—on that side trouble is developing, too. Under the compelling influence of rising costs of living, all branches of government are facing growing and insistent demands from their employees for higher pay. This demand is difficult to

resist because of the wage increases that have been granted in private industry, and especially the high rates offered by armament plants in certain localities.

Added to the wage problem is the problem of increasing costs of supplies, materials and equipment needed for the operation of public services and the maintenance of plant. In the institutional field, the difficulty of making both ends meet is especially acute. Appropriations made in Minnesota in April of this year, and allowing what seemed to be a reasonable margin for higher commodity prices, may easily reach the danger point unless existing price trends are checked. (A good illustration is the rise of approximately one dollar a barrel in the price of flour. Our 19 state institutions consume about 22,000 barrels of flour annually, so this one increase adds $22,000 to our cost of operation. One year ago we were able to get unbleached sheeting for less than 14 cents a yard. The price of this material, of which we use 130,000 yards a year, has doubled. Other textiles necessary for the operation of our institutions have gone up similarly. Canned goods are up 25%.)

The only offsetting factor is the inability to obtain certain items, particularly in lines such as steel, rubber, aluminum and other products covered by priorities.

I believe that we must definitely expect real difficulties in all of our states. At the same time I believe that it is essential that financial soundness be preserved, and our citizens must be active to see that this is done. I am aware that the tendency is all the other way. I know that the official who tries to operate economically and the citizen who steps forth to voice a demand for retrenchment today are working before a backdrop of fabulous national spending. It is hard to get people stirred up over the spending of a few thousand or a few hundred thousand dollars by one of our local units of government, when the federal government is pouring out billions which it does not even possess on the vast undertakings it is pushing. Yet we must somehow focus attention on the necessity of financial soundness. There is no justification whatever for shelving the idea of a balanced budget, and the people must be made to see that this is true. We must endeavor now, more than ever before, to make the people realize that the money which our governmental units spend does not come off the trees, but is paid, as President Roosevelt once said, out of the toil and sweat of every man who works. We must turn our thoughts anew, officials and citizens alike, to a searching analysis and reappraisal of the expenditures of our state and local governments and determine where in the light of today's demands reductions in spending may well be made. Conditions affecting the sources of our revenue today are not what they were yesterday. Tomorrow they will be even more changed. Our spending programs must be adjusted to meet changed conditions and the needs of today.

We may have to revise our conception of raising tax revenues, particularly the earmarking of taxes for specific purposes. Necessity may force us to place all tax revenues in one fund instead of ten, twenty or fifty, and apportion it out among the various needs without respect to its type or source. In the light of what we are facing today in most of our states, can there be any justice or common sense in allowing millions of dollars in dedicated funds for one activity, when relief and welfare services or schools must skimp along on inadequate revenues? We may be forced by necessity to hasten the day when the people's funds will be distributed in accordance with the needs of the people today instead of on the basis of what organized groups were able to garner for their special interests in other years. Accompanying this fortunate change, when it comes, will be a return to the legislatures of our states of the authority to appropriate from session to session funds for operation of many departments. Our legislatures in many states now are able to make appropriations for only a small part of the state's spending. For instance, in Minnesota in the 1940 fiscal year, an analysis showed that the legislature had direct control over only 21.2% of all the state's revenue. Dedication of funds has taken out of their hands control over budgets of many state departments and destroyed this valuable check on spending.

Necessity well may force us also to take other steps to improve our local governmental machinery, such as modernizing and simplifying our county structure. This depends, of course, upon the duration of the emergency.

But there are immediate steps that can and must be taken. For one thing we can and must cut out or reduce the volume of spending for capital improvements. The federal government needs many of the materials used in highway and other public works which are vital to national defense. The states and their municipalities should do nothing to impede the defense program by insisting on making major improvements now. And it is high time that we quit trying to reason that everything we do has a defense angle to justify it. Frankly some of our excuses are pretty flimsy, in my opinion.

But entirely apart from the aspect of unnecessary competition with the federal government for vitally needed materials, there is the long-time aspect of having a back-log of public works to be carried on at a later date when unemployment occurs with the cessation of the arms production program. The federal government is already seeking to take the lead in developing a works program to take up the slack a year, two years or three years from today. That is a far-seeing policy to the support of which every state and every other unit of government in the country should give intelligent consideration immediately.

We should make a reappraisal of all the activities of local and state governments, as I have suggested before, and reduce expendi-

tures that well may be curtailed so that we will have sufficient funds for the services more vitally needed today. We cannot meet today's problems or the problems of tomorrow with yesterday's unchanged program. Nor can we ignore the conditions that challenge our attention and blithely borrow to build a bridge over the unpleasant road that lies ahead. We must roll up our sleeves and work. Getting down to rock bottom, we must hold all borrowing down to the lowest amount possible and eliminate all the unnecessary expenditures we can.

The adjustments that will be needed will not be easy to make. War-time necessities place a dangerous strain on many governmental processes. In the interest of speedy results it is easy to set aside, suspend or revoke the normal procedures. Thus we have cost-plus, negotiated contracts and other shortcuts. The difficulty will be in returning to the older procedures once the emergency has gone.

We have been interested, all of us, I think, in the advancement of government and have seen many specific improvements introduced as men sought to make it better serve the people. It has been my good fortune to see government at close range as a research man attached to private agencies interested in improving the efficiency of government and again as a commissioner of administration helping to install improvements and watching them develop from day to day. We have seen introduced in our state in the last three years a civil service system for state employees, a central financial control system which adjusts spending to income, a labor conciliation law that is reducing the number of strikes and lockouts, a central purchasing department with open and competitive bidding, and other far-reaching improvements that largely have transformed our state government and increased its usefulness and effectiveness. In other states as well, vast improvements have been made. In many of our cities and counties, government has advanced unmistakably. While devoting all the great energies that we are to the national defense program, let us not relinquish the gains we have made in the ordinary processes of government. Let us rather keep attention of our citizens focused more clearly upon the problems of our local governments and together prepare for their more effective administration when the war is over and the national emergency passed.

SEVENTH SESSION

TUESDAY, OCTOBER 14, 9:45 A. M.

Museum of Natural History Auditorium
University of Minnesota

Simeon E. Leland, presiding.

CHAIRMAN LELAND: We are going to discuss this morning various aspects of the problems connected with war and national defense. The first paper is on the federal financial situation. We are indeed fortunate in having with us the author of the paper, who will speak for himself, Mr. Roy Blough, head of the Division of Research and Statistics of the United States Treasury Department. We are sorry that Mr. Sullivan couldn't be with us.

It is with great pleasure that I introduce Mr. Blough, who will discuss the federal fiscal situation.

ROY BLOUGH: Mr. Chairman, Members of the Conference: Despite the kind words of the Chairman, I know you are disappointed in not having Mr. Sullivan here, because you want to hear the remarks of the responsible policy-making person in the Treasury, and that person would have been the Assistant Secretary, Mr. Sullivan. He asked me to express his sincere regrets that he was unable to be present, and I am very sorry myself, as you may well imagine, that he is unable to be present.

THE FISCAL SITUATION

ROY BLOUGH

Director of Tax Research, U. S. Treasury Department

The development of our defenses has been made our most compelling concern by developments in foreign lands. The basic economic problem of the United States today is to devote whatever amount of national production is necessary to assure its defense through democratic methods. In the solution of this problem the rôle of finance is important, for the financial operations of expenditure, taxation and borrowing are largely relied on to expand defense production and to make the necessary shifts to a defense economy.

EXPENDITURES

Prior to the fall of France in the Spring of 1940 the expenditures of our War and Navy Departments were at a level which to many people seemed large amounts. In fiscal 1940 these expenditures amounted to $1,560 million. This amount reflected substantial growth over a period of years. Five years before, in 1935, for example, such expenditures amounted to $710 million. After the fall of France the appropriations and authorizations for defense mounted rapidly. By the time the 1942 budget message was presented in January, 1941, the overall defense program, measured by appropriations and authorizations passed or pending, had risen to $28.5 billion. When the revised budget estimates were released on October 5, 1941, the total had more than doubled to $60 billion, including Lend-Lease aid, with more to come.

The amount of $60 billion is not, of course, to be expended in any one year but over several years. The more rapidly it can be expended to secure the desired results the more effective is the program. In fiscal 1941 defense expenditures totaled $6,255 million. During September, 1941, defense expenditures totaled $1,320 million, or more than five times the expenditures of the month for the preceding year. The September expenditures were at an annual rate of nearly $16 billion. The budget estimate for fiscal 1942 is $18 billion of defense expenditures. What the amount will be for fiscal 1943 is not here forecast but it should be substantially in excess of the 1942 figure if world conditions continue as they now are.

In the fiscal year 1941 defense expenditures equaled 8 percent of the national income. During the first quarter of fiscal 1942 defense expenditures were 15 percent of the national income. This percent will continue to increase. By comparison, in England war costs absorb at least 40 percent of the national income and in Germany over 50 percent.

Federal non-defense expenditures have shown little change. For fiscal 1942 they are estimated at $6.6 billion, which is slightly more than in the preceding year. Total expenditures, defense and non-defense combined, for fiscal 1941 were $12.7 billion and are estimated at $24.6 billion, or nearly double for fiscal 1942.

REVENUES AND RECEIPTS

The net receipts for 1941 after deducting appropriations for the Old Age and Survivors' Insurance Trust Fund were $7.6 billion and are estimated at $12.0 billion for 1942. This increase of $4.4 billion is due in part to the larger volume of business and higher incomes of recent months and in part to the tax increases made by the Revenue Acts of 1940 and 1941. The two Revenue Acts of 1940, both of which were introduced and passed after the foreign crisis had developed, were estimated to increase revenues by approximately

$1.5 billion at the income levels of that year. The Revenue Act of 1941 is estimated to increase tax yields by $3,553 million. Since there is considerable delay in collecting tax increases, especially in the case of the income and profits taxes and the estate tax, the full effects of even the Revenue Act of 1941 will not be fully felt until fiscal 1943 and thereafter.

PUBLIC DEBT

The first Revenue Act of 1940 increased the statutory debt limit by $4 billion, bringing the limit to $49 billion plus additional amounts on outmoded forms of debt not suitable for use under present conditions. Early in 1941 the overall debt limit was increased to $65 billion. The debt on June 30, 1941 totaled nearly $49 billion. If the deficit of over $12½ billion estimated for 1942 is realized, the debt on June 30, 1942 will be approximately $61½ billion.

The interest on the public debt had not increased as rapidly as the debt, due to falling rates of interest. The annual interest charge computed as of the end of fiscal 1941 was $1,218 million, or very slightly over 2.5 percent average rate of interest on the interest-bearing debt, which is a lower rate than has existed at any time since the first World War.

THE FISCAL PROBLEM AHEAD

The fiscal situation may thus be summarized briefly as follows. Revenues at existing levels of business will be substantially in excess of the recent level of expenditures. For example, total budget expenditures in fiscal 1940 were $9.1 billion, while comparable receipts for fiscal 1942 are expected to be $12.0 billion, or nearly $3 billion more. However, with defense expenditures rising to an estimated level of $18 billion there will be an estimated deficit of $12.6 billion in fiscal 1942.

There are many objectives to be considered in facing our present fiscal problems:

(1) Since a strong and united morale is essential to the defense program, the financial burden should be equitably distributed among the various income and economic groups;

(2) Since the main purpose is to maximize defense production, the methods of financing should avoid interfering with the effort to secure maximum production;

(3) Since our defense program is being undertaken to preserve our way of life, fiscal policy should promote conditions favorable to an economic system of free enterprise;

(4) Since people dislike to pay for money spent and benefits received long ago, and since the distribution in the future of the burden of paying the debt cannot be forecast, it is desirable to distribute the fiscal burden finally as soon as possible;

(5) Since tax collections for the payment of interest have the same disturbing and repressive effects as other taxes, the amount of interest payments to be made in the future should be kept as low as possible;

(6) Since inflation is in effect taxation in a very pernicious and undesirable form, it should be avoided or kept at the smallest possible magnitude.

THE THREAT OF INFLATION

Avoidance of inflation is important and pressing. Some inflationary price rises have already occurred. Our position is in many respects similar to that existing in 1916. There are many factors in the picture, a few of them operating in the direction of holding down prices but most of them in the direction of pushing up prices. The fundamental fact is that money incomes are being paid out to people on the basis of total production, defense and non-defense combined, while only non-defense products are available for purchase with these incomes. Unless the surplus of money incomes over available goods at existing price levels is absorbed in other ways or held idle, prices are bound to rise.

During the course of the late depression many commentators almost continuously warned of immediate inflation because of fiscal deficits, but no inflation occurred, except minor price recoveries from the depths reached in the depression. During those years there were unemployed workers and excess plant capacity in almost every line of industry. The increased money incomes due to governmental deficits resulted in an expansion of production rather than price inflation. The situation is different now. There is already a shortage of certain kinds of skilled labor. When the adjustment from non-defense to defense industry which is now causing dislocation in come areas has been completed, there may well be a general shortage of labor. The plant shortages and raw material shortages are too well known to require comment. It may be possible eventually to expand civilian goods in large volume but in many lines this is difficult in the short run and there will undoubtedly be serious reductions in the volume of many kinds of goods.

There is accordingly a very grave threat of inflationary price rises, not on the order of German or French inflations after the last war, but more on the order of the price rises in the United States during the World War, which had serious repercussions on American life.

TAXES

Most of the fiscal objectives mentioned above point to taxation as the preferred method of financing the anticipated deficit. Taxes absorb purchasing power, thus relieving inflationary pressure; tax financing distributes the defense burden more definitely than bor-

rowing and it eliminates the interest charge. To cover the entire expected deficit of over $12 billion in 1942 by levying new taxes would, however, be well-nigh impossible because of the time factor involved. More important, the economic repercussions and personal budgetary adjustments resulting from sudden new taxes of this magnitude would be extremely serious.

Certainly taxes should be used to the utmost within the economic limits. The Treasury Department's recommendation of a $3.5 billion tax bill last April (1941) was more than many persons expected. Rapidly-moving events revealed the insufficiency of this amount. In July Secretary Morgenthau called the attention of the country to the fact that the revenue from the bill had become inadequate even before the bill was passed, and indicated that an all-out tax bill would be necessary to finance an all-out defense program. That there will be a heavy increase in taxes within the next year is anticipated by everyone.

SAVINGS BONDS

Since taxes cannot meet the whole deficit, it is necessary to borrow. Next to taxes, the most desirable method of financing is by borrowing from the masses of people funds which they would otherwise spend on goods competing with defense. Such borrowing reduces the pressures tending to inflationary price rises.

A form of borrowing to meet this problem has been provided in the Defense Savings Bonds. Sold on a purely voluntary basis, without the quotas and social and economic pressures of the bond issue drives of the last war, it is expected that during fiscal 1942 they will supply $3.6 billion.

It is not known to what extent the purchases of savings bonds are coming out of current income that would otherwise be spent and to what extent out of previously accumulated or other idle cash balances. It appears likely that as certain forms of consumer goods become harder to secure the savings bond purchases will come more and more out of current income.

TAX ANTICIPATION CERTIFICATES

Part of the taxes on 1941 incomes that would ordinarily not be paid until fiscal 1942 will be collected through the sale of tax anticipation notes. These notes are issued and sold for the purpose of enabling taxpayers to accumulate funds for paying their taxes, such accumulation being increasingly needed as tax rates increase. At the same time the prepayment of taxes has a salutary effect on prices. An incidental result is to speed up receipt of the funds into the Treasury and to make unnecessary the borrowing of such amounts through sale of other forms of securities.

SPECIAL ISSUES TO GOVERNMENT-HELD FUNDS

Another source of funds to meet the fiscal deficit is the sale of special issues to funds held by the federal government. During the fiscal year 1941, the special issues accumulated in such funds increased by $1,345 million. More than $1,200 million of this amount came from increases in the Old-Age and Survivors' Insurance Trust Fund and the Unemployment Trust Fund. These funds and the others holding the special issues are accumulated from taxes and contributions, so that the immediate economic effect is non-inflationary in the same manner as taxes and defense savings bonds.

INSURANCE COMPANIES

The insurance companies for years have been substantial purchasers of federal bond issues and it can be reasonably anticipated that their purchases will continue. In fiscal 1941 insurance companies added approximately $400 million of federal securities to their portfolios. Indeed the demand of wealthy individual investors for the fully exempt state and municipal securities and the possible decrease in new private issues may result in a large volume of federal issues being purchased by insurance companies. Purchases of federal securities by insurance companies represent true savings and in general do not add to the inflationary pressures.

BANKS

After taxes, defense savings bonds, tax anticipation notes, trust fund and insurance company purchases (together with those of business corporations) have been fully utilized, the remainder of the funds necessary to meet the deficit will undoubtedly be raised from banks. Some of these purchases will represent the investment of new deposits that might otherwise be put to other uses. In general, however, it may be anticipated that new deposits will be created by bank purchases of governmental securities. These new deposits represent purchasing power that exerts inflationary pressure; they are the chief source of the inflationary tendencies of a fiscal deficit. The policy of the Treasury Department is to borrow the maximum amount from non-banking investors.

OTHER MEASURES TO CONTROL INFLATION

The financial policy of the government is thus greatly influenced by its concern about the inflation problem and the desire to obtain a maximum of receipts in non-inflationary ways. Since such receipts are not likely to be sufficient to cover the deficit, even approximately, the existence of inflationary pressures from fiscal deficits is almost inevitable. Accordingly, to avoid inflation, it is necessary to resort to other measures. It should be strongly urged that neither fiscal measures nor non-fiscal measures alone are likely to succeed; the problem must be attacked from all sides at once.

Discussion of the non-fiscal measures in any considerable degree is outside the scope of this paper, but it may be noted that they all proceed along one of three lines:

(1) Some measures seek to increase the supply of civilian goods and services so that there will be more goods and services for which money income can be spent. In numerous lines, such as amusements, personal services, and non-metallic products, production can be increased without interfering with the defense effort.

(2) Other measures seek to reduce the demand directly. An important example is the control of instalment credit which reduces the transformation of expected future income into present demand. In some foreign countries direct rationing serves this purpose.

(3) Other measures seek to prevent the spiraling forces of inflation from operating. These forces arise not only from necessary increases in costs due to substitution of materials and for other reasons. They arise also because at a time when economic standards generally must fall many people take advantage of the situation to keep up their previous economic position or actually to improve their position by raising prices for goods, services, labor, etc. These add to the costs of doing business and are passed on in higher prices, which add to other costs and prices. Much of the increased cost must rest on the government, which is a very large purchaser. Its higher costs increase the fiscal deficit, which in turn increases the amount to be borrowed. The result is a vicious spiral. Direct attack on prices seeks to meet the problem by preventing or slowing this spiral process.

CONCLUSION

The fiscal picture changes as the defense picture changes. It is not yet clear how large the defense program will finally be or how long it will continue. Accordingly, it is not possible at this time to lay down any definite plan for financing the program with amounts allocated to different sources of funds. I have endeavored to present a brief picture of the magnitude of the problem, to indicate the different sources of funds which are available, and to outline the fiscal policies which the Government appears to be following in financing the defense program.

Whatever method of finance is used, the magnitude of the problem in terms of our national income and economic life is so great that a tremendous effort will be required in order to avoid hardship, uneven sacrifice and economic dislocation. It will take the fullest cooperation of all our people to achieve the fiscal program we need—one that will render the maximum support to the defense effort and the well-being of our whole population.

CHAIRMAN LELAND: We are certainly indebted to Mr. Blough for a most clear and thorough-going statement, at least of the policies to date, and the fiscal control position of the government.

Part of the problem of war finance, or defense financing, is, so far as we are concerned, to find the precedents and events that have been going on abroad. We have much to learn from our neighbors, both on this side and the other side of the Atlantic, and the next paper is to deal with Canadian experience. Unfortunately, Mr. Coyne, the Financial Attaché of the Canadian Embassy in Washington, cannot be here, but we are indeed fortunate in having Mr. J. H. Bieler, who was for many years connected with the League of Nations, and in the last years of its existence was its budget director, and who is now the economist for the Treasury Department of Quebec here, and Mr. Bieler is going to give us a summary of some of the things which Mr. Coyne either would have said or might have said, with his own interpolations.

Mr. Bieler, we are happy to have you with us this morning.

NATIONAL DEFENCE FINANCING IN CANADA

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During the present year, about five-sixths of Canada's national financial requirements are for war purposes, as compared with one-sixteenth in the last pre-war year, 1938-39. In less than three years, the actual amount has been multiplied 69 times. That is merely a cold statistical statement of the fact that the people of Canada are engaged in the greatest national undertaking in their history, the mobilization, organization and direction for a single dominating national purpose of as high a proportion as is humanly possible of the entire resources of the country in men, machines, and materials.

There are today 340,000 men in the Canadian army, navy and air force, all voluntarily enlisted for service anywhere in the world for the duration of the war. Over 100,000 are at present in the British Isles, the remainder in Canada and North American outposts. By next March, the total will have increased a further 20% to over 400,000. That is the equivalent of 4,600,000 men in terms of the population of the United States. In addition, we have a Reserve Army of 170,000 men (a further 2,000,000 in United States terms) trained or in training for home defence; most of these are engaged in civilian occupations and on call if they are needed, but an increasing percentage of the total consists of men drafted under national conscription for full-time service for home defence for the duration of the war; new classes are called up monthly by age groups.

The equipping and maintenance of these forces, and the operation of the huge undertaking known as the British Commonwealth Air Training Plan, naturally constitute the major part of Canada's war expenditures. The expansion of war production has gone far beyond these requirements, however. It has long been clear, and particularly since the fall of France, that Canada has the opportunity and the duty to fulfill a vital rôle in providing the tools of war in much greater quantities than those required for its own armed forces. Ships, aircraft, tanks, armoured vehicles, artillery, anti-aircraft guns, machine guns and small arms, huge quantities of shells, ammunition and explosives, radiolocators and other special equipment and strategic metals are being produced in ever-expanding volume, as well as food and lumber and other raw materials for shipment overseas. Shipment of munitions and war materials has been made to Great Britain, the other Dominions, the Near East and the Far East, and will shortly be made to the United States, China and Russia. With respect to Britain and the rest of the Empire, most of the total expenditures, that is, all of their net deficiency of Canadian dollars, has to be financed by Canada.

In money terms, Canada's war effort for the first two years of war amounted to $2,225,000,000, including aid to Britain. The present accelerated pace calls for total war expenditures in the current fiscal year, which began last April, of $2,350,000,000, including aid to Britain. To put these figures in perspective for an American audience, in terms of relative national income, they should be multiplied by at least 15. On that basis, war expenditures up to last August were equivalent to 33 billion dollars, of which 13½ billion was in aid to Britain. For the current year alone, the total will be equivalent to 35 billion dollars, of which 22 billion will be Canada's direct war effort and 13 billion aid to Britain.

In addition, there are non-war expenditures of the federal government, and the normal expenditures of provincial and municipal governments. Total financial requirements of all governments this year will be equivalent in United States terms to nearly 50 billion dollars, or well over 50% of national income; federal requirements alone are equivalent to about 42 billion dollars.

Total financial requirements are determined by the capacity of the country to provide the physical resources needed for modern war and by the skill and organizing ability of its people. The task of finance in the strictly fiscal sense is simply to choose and put into effect the best combination of financial measures for achieving the objective of a maximum war effort. The particular measures chosen, however, and the degree of their application, will also be affected by considerations of general economic and social policy and by the measures adopted in those fields. Acordingly, even in discussing taxation and government borrowing, I shall have to mention certain

objectives other than the mere raising of money, and to present a balanced picture it will be necessary to follow up the description of fiscal policy with a brief discussion of action in other fields. The governing factor in them all, of course, is the objective of a maximum war effort.

With respect to taxation, it is estimated that federal tax revenue in the current year will be more than three times as great as in 1938-39; combined tax receipts of the federal, provincial and municipal governments will be almost one-third of national income. The objective is so far as possible to pay as we go in money terms, for, certainly, in physical terms the costs of war are paid almost entirely while the war is being fought. Federal taxation, this year, will yield about 74% of requirements for direct war expenditures, and non-war expenditures, or about 50% of total financial requirements including aid to Britain.

The increase in taxation over the past three years has, of course, been gradual, the question of timing being of great importance. The increase in rates in 1940 was roughly duplicated in 1941, although in terms of actual revenue the expansion of national income is naturally producing a much greater dollar-increase this year.

These increases have been applied much more to taxes on income than on expenditures. The yield from personal and corporate income taxes has quintupled since 1938-39, while that of customs, excise and sales taxes has doubled. This represents a very pronounced shift from the previous reliance on indirect taxes as the major source of federal revenue. The financing of huge war expenditures, which have been directly responsible for the expansion of national money income to unprecedented levels, has had a considerable levelling influence on individual incomes.

The changes in the personal income tax amount to a complete overhauling. In the first place, the national defence tax, introduced in June 1940, in effect abolished personal exemptions by imposing a flat-rate tax on total net income. The ordinary income tax was thus converted into a graduated surtax. The national defence tax does not apply to married persons with incomes under $1,200 nor to single persons with incomes of less than $660, but those earning more than these limits are taxed on total net income, not just on the excess over the limits.

Another feature of the national defence tax is that it is deductible at the source. This is a wholly new departure in federal income taxation in Canada. That method of administration was necessary in dealing with large numbers of new taxpayers with relatively low incomes, and the conditions of the collection system in turn made necessary the distinctive features of the tax, namely, the flat rates, absence of personal exemptions, and provision for dependents' allowances by means of a tax credit of $20 for each dependent rather than segregation of taxable and non-taxable income.

A new development in the graduated personal income tax has been the establishment of a system for payment of taxes by twelve monthly instalments, commencing seven months before the due date for a lump-sum payment and extending without penalty five months after that date. This method of payment is not compulsory, but there are obvious advantages in it and it is being more and more widely adopted.

The rates of tax are, of course, the highest in our history. The national defence tax is 5% on the total net income of a married person, or of a single person earning less than \$1,200, and 7% in the case of a single person earning more than \$1,200. The graduated income tax now applies to net income in excess of \$1,500 married or \$750 single, the exemptions having been reduced to those levels in 1940; there are additional exemptions of \$400 for each dependent. The rates are now 15% on the first \$1,000 of net income after exemptions, 20% on the second \$1,000, 25% on the third \$1,000, and so on in the familiar curve. To give a single illustration, a married man with no dependents and earned income equivalent to \$5,000 in U. S. funds, who would have paid a tax of \$120 in 1939, will this fiscal year pay \$1,068, as compared with \$1,855 in England (which includes \$226 in the form of a forced loan) and \$375 under the new U. S. Revenue Act.

There is also a special surtax of 4% on all forms of investment income, and, as mentioned below, very heavy taxes on business profits which further increase the combined income tax on income from equity capital. It should be noted, however, that provincial and municipal income taxes will probably be withdrawn for the remainder of the war, a development which is discussed more fully in a later part of this paper.

With regard to corporation income taxes, we follow the same practice as the United States, and, unlike England, do not allow the tax paid by the corporation to be credited against the personal tax on dividends received by the shareholder. The rate before the war was 15%, and was increased to 18% in September 1939. In 1940 and 1941, however, the excess profits tax act was amended so as to provide a minimum tax on total profits of corporations, even if there were no excess profits. That minimum rate is now 40%. In effect, the excess profits tax act applies a surtax of 22% on total net income in place of the tax on excess profits, if the latter will not yield a greater amount.

The excess profits tax itself is a flat 75% of the amount by which total profits exceed the average profits of the four years 1936 to 1939 inclusive. Since the standard tax of 18% is also applied to excess profits, but is deductible from those profits, the net effect is an income tax of 79½% on excess profits. There is no graduation or variation based on the source or absolute size of profits, or on the

relative increase over pre-war profits. The net result is that in almost every case a corporation pays substantially higher taxes on profits in Canada than it would in England.

I will not attempt to go into the details of what must, in any country, be a very complicated statute. There are, however, several points which may be of special interest for purposes of comparison with other countries. The first is that in the original 1939 act taxpayers are given the option of being taxed either on profits in excess of average pre-war profits, or on profits in excess of a fixed return on capital. The latter provision was found to be unsatisfactory from the administrative point of view, and likely to cause great discrimination by letting some businesses off too lightly. The whole 1939 act was in fact withdrawn, and in the 1940 act the principle of return on capital was retained only for special cases where the average-profits principle would work undue hardship. The method is in such cases to adjust standard profits to what a fair return on capital employed would have yielded; this is permitted, for example, where a business was abnormally depressed during the standard period, or commenced operations later than half-way through the standard period, or where the amount of capital employed was substantially altered during or after the standard period.

Such an excess profits tax with extremely high rates and operating under wartime conditions is subject to two obvious defects; on the one hand, it may encourage wastefulness and disregard for costs, since the government in effect pays 80% of additional expenses incurred, and of course the temptation to evade taxation is much increased; on the other hand, it may discourage enterprise, necessary increases in production and particularly war production, and the taking of risks of any kind. Overcoming the first of these difficulties requires a large degree of administrative discretion, which is also a feature of other provisions of the Canadian act. Rather than attempt to spell out in the act itself detailed rules for the many different types of exceptional cases which may arise, a Board of Referees was appointed to deal with the cases already mentioned where return on capital is to be taken into consideration. The Minister of National Revenue may also direct the Board to determine standard profits on whatever basis it thinks just, if he is satisfied that the circumstances of a depressed business or a new business cannot be adequately provided for by reference to capital employed. To overcome the temptation to incur unjustifiable expenses, the Minister may disallow any expense of a taxpayer which he deems unreasonable or abnormal for the business, and the Treasury Board, which is a committee of the Cabinet, may direct that any transaction which it believes to be artificial or designed to evade taxation shall be disregarded, and may in such case assess any tax which it thinks fit. These latter powers are of course used sparingly, but they indicate the degree of informality and elasticity which is possible in

the administration of a small country. On the whole, Canadians feel that laws depend more on administration and public acceptance than on strict wording and literal enforcement; at least there has been little evidence of lack of confidence in the way in which administrative discretions are exercised.

To meet the other difficulty mentioned, special amortization rates are allowed in respect of profits on war contracts if the normal arbitrary rates devised for ordinary commercial business would be obviously unrealistic; here, again, wide discretion is given to an administrative body, the War Contracts Depreciation Board. Another example is the special provision for the setting up of inventory reserves in accordance with price rises since August 1939 as a protection against subsequent price declines; if prices do not fall, however, the reserve must be brought back into profits after the war in the last year to which the excess profits tax applies.

In the field of direct taxation, the war has also brought the first federal succession duties or inheritance taxes, hitherto levied only by the provinces, though there was no legal impediment to federal action. Since it would be unfair to single out for taxation of this sort that minority of the population whose parents or husbands happened to die during the war period, it was indicated in the 1941 Budget Speech that this new federal tax must be regarded as permanent, or at least as having more permanence than the wartime increases in income taxes or indirect taxes.

The new federal tax is of a composite type; it applies to the amount passing to each beneficiary, and the rate is determined mainly by the size of each amount, but also by the size of the total estate and the relationship of the beneficiary to the deceased. The existing provincial rates vary considerably from province to province; the federal rates are designed to be somewhat lighter than the average provincial rates, and to fit in as well as may be with the heaviest of the provincial rates. On the whole, this has meant that the federal rates lay more emphasis on medium and small estates than on large estates which are already heavily taxed by the provinces. The combination of the new federal rates and the provincial rates will for most provinces result in a total tax of about the same general magnitude as the British death duties, but with considerable differences in detail. In particular, the total Canadian rates would be somewhat higher than the British rates on other than close relatives, but lower where an estate is divided among a number of members of the deceased's own family.

Turning now to indirect taxes, most of the wartime changes have been made with special ends in view; the raising of revenue from indirect taxes has so far been a secondary objective and the increase of revenue has been chiefly a reflection of higher business activity. Thus the general sales tax of 8% has not been increased, though the exemption of building materials was withdrawn this year, there

being no reason to encourage non-war construction at this time, but rather the reverse. Increases in the customs tariff have been negligible. On the other hand, there have been substantial reductions in the duties on imports from the British Empire, with a view to offsetting higher transportation costs and also to help reduce the British deficit of Canadian dollars. The war exchange tax, 10% ad valorem on imports from countries outside the sterling area, was imposed in 1940 primarily as a means of conserving the nation's supply of United States dollars. A series of excise taxes or sales taxes on particular goods have been imposed with a view to reducing, or at least preventing further increase in, the civilian consumption of non-essential goods which use up scarce resources or which, being largely imported from the dollar area, use up scarce foreign exchange; to the extent that a particular tax of this sort fails to affect consumption of the particular article taxed, it has the alternative merit of producing revenue and thereby absorbing surplus purchasing power and reducing the demand for other goods. Another object of some excise taxes has been to capture the windfall profit that might accrue to domestic suppliers of goods which are not permitted to be imported under the War Exchange Conservation Act.

Among the excise taxes which serve one or more of these purposes are the following, all of which reflect substantial increases over pre-war rates and many of which are new: Automobiles, 25% on value up to $900, 40% on next $300, and 80% on value over $1,200 (value means manufacturer's price or duty-paid value of imports); cameras, photographs, radios, electrical appliances, slot machines — 25%; soft drinks, 25%; toilet articles and preparations, 25%; amusement tax, 20%; transportation fares, 10%; cigarettes weighing not more than 2½ lbs. per thousand, tax of $6 per thousand; other cigarettes, $11 per thousand; cigars, from $4 to $35 per thousand, depending on the price; sugar, 2c. per lb.; distilled liquors, $7 per gallon; the 8% general sales tax also applies to most of these goods.

The war has also affected federal-provincial fiscal relations. The gains and losses in economic activity resulting from the war have greatly exaggerated the previous inequalities in the taxable capacity of the different provinces and municipalities, while provincial and local expenditures remain more or less fixed, with the exception of capital expenditures which have been largely eliminated. The federal taxes leave in some cases not sufficient taxable income for local revenues, while in other cases huge federal expenditures provide a gratuitous and abnormal source of revenue to a particular locality.

The federal government has now raised personal and corporation income taxes to much higher levels than the previous combination of provincial and federal rates, and has for the first time levied gasoline taxes and succession duties which also cut across provincial revenues. In times of heavy taxation, especially in wartime, it is

more than ever desirable, and in fact necessary for a maximum war effort, that inequalities between citizens in different parts of the country should be reduced or eliminated by federal action, while at the same time the federal government is under an obligation to see that its own policies do not impair but rather assist to maintain the solvency of any province which is prepared to cooperate in furthering the national war effort in the financial field.

The federal government has accordingly proposed to each province that the province and its municipalities should vacate the income tax field entirely for the duration of the war. In return, the federal government will pay the province an annual amount equal to either the actual receipts from such taxes in 1940 or the actual amount of interest paid in 1940 on the province's public debt, whichever is the greater. In addition, the federal government will make good to the province the amount, if any, by which provincial gasoline tax receipts fall short of 1940. It is a further condition that subsidies heretofore paid by the federal government to the provinces shall be suspended, but special subsidies based on fiscal need will be paid to such provinces as may need special assistance. It seems virtually certain that these proposals will be accepted.

So much for the chief changes in taxation for national defence financing in Canada. The total burden of taxation has been greatly increased, and is now very high; even so, the increase in tax revenue does not take much more than half the increase in national income, whereas more than the whole increase in national income is being and must be devoted to war purposes. The physical facts of the situation can only mean a reduction in the standard of living of the people as a whole, and those facts are inevitably reflected 100% in national financial requirements. Fiscal policy has imposed a differentiated scale of sacrifices bearing most heavily on the highest incomes; all but the very lowest incomes must, in one way or another, bear the burden not only of the entire costs of war but of the somewhat increased individual or family incomes of, say, the lower third of the income groups.

The ultimate gap between government revenues and expenditures must be met by borrowing from the public. There are, however, several sources of funds intervening between taxes and public loans. The first is the ordinary non-tax current revenues, including post-office receipts. Secondly, the federal unemployment insurance scheme came into operation this year; at a time of full employment receipts will greatly exceed disbursements, and the excess is invested in government securities; this is done by purchase in the market, which has the same effect as direct loans to the government, for additional funds are made available to the public for their subscription to war loans. Other government trust accounts provide funds in much the same way. Thirdly, the expansion in national income and general economic activity requires a proportionate

amount of monetary expansion, and it is government borrowings through the banking system which produce this expansion.

The final residual amount to be financed by public borrowing is very large, however. Voluntary and compulsory reductions in unnecessary civilian consumption must be secured in a variety of ways, and the money so released made available by voluntary or compulsory loans to the government. So far Canada has not resorted to any form of forced lending, relying instead on war loan campaigns, and on the sale of war savings certificates to persons of low or moderate incomes.

Public borrowing has been facilitated by the control of private investment. On the side of the investors, foreign exchange control has prevented funds being sent abroad and neutralized the attraction which, at least in the early days of the war, might have been exerted by the New York stock market. Within Canada, investors have been subject not only to the patriotic appeal, which has resulted, for instance, in the large insurance companies confining their new investments almost entirely to war loans, but also to the deterring influence of high taxation of business profits and the continual warnings from the beginning of the war that production for civilian consumption would inevitably be curtailed once full employment of existing resources had been attained.

On the side of prospective borrowers, the same indirect influences discouraging expansion of production for civilian consumption have been operative. Expansion of facilities for war production has been largely financed by the government; new plants, extensions and alterations are for the most part either government owned and operated under lease or for a management fee, or in some cases financed by government loans. In the field of civilian production, indirect controls necessarily gave way to direct controls when full employment was reached or was in sight. On April 29, 1941, formal and fairly strict control was established over new construction or extensions of buildings for industrial and commercial use, and over the installation of machinery and equipment. This was, of course, established for the purpose of conserving physical resources and diverting them to war use; the reflection of this in the financial field is that private capital which would otherwise have gone into such private investments is instead left with little outlet except government bonds.

The first public loan, in February, 1940, produced $250 million in new money and conversion subscriptions; the second, in October, 1940, $325 million; and the third, in June, 1941, a total of substantially more than $800 million, despite a decline in interest rates. The latter sum is the equivalent of over 12 billion dollars in United States terms. The first two loans were obtained without much difficulty largely through the usual methods, though a nation-wide organization for special campaigning was begun at the time of the

second loan. For the third, called a Victory Loan, which was much larger than anything previously attempted and came shortly after the heavy taxes in the 1941 budget, a long campaign was carefully planned to reach every individual in the country through hundreds of local committees. In the result, 950,000 subscriptions were received, amounting to the sum previously given, or the equivalent of 11,000,000 individual subscriptions in terms of U. S. population. Banks were not permitted to subscribe, except in respect of conversions, which amounted to only a small fraction of the total of over $800 million.

The total amounts received from the sale of war savings certificates seem small in comparison, but the war savings campaign, which goes on continuously, is of great importance in the inducement to save, the opportunity to make a further contribution to the war effort, and the building up of post-war reserves, on the part of millions of men, women and children throughout the country, most of whom could not subscribe to war loans. These certificates yield 3% free of income tax if held to maturity, 7½ years after the date of purchase, being sold for $4 or multiples of $4 and redeemed at $5 for each $4 paid in. No person may purchase more than $600 worth, i.e., subscribe more than $480, in each calendar year. The majority of the subscriptions are made regularly each month, either by virtue of a written order to a bank to debit the subscriber's bank balance, or under a payroll deduction plan.

The payroll deduction plan is obviously the most satisfactory one for the wage-earner, and an extensive and continuous campaign is carried on to obtain the cooperation of all the businesses in the country, and all their employees. Many businesses, large and small, have achieved 100% participation. War Savings Stamps are also sold, at 25c. each, for accumulation until enough have been bought to be turned in for a war savings certificate. Over 12 million of such stamps are continuously outstanding in the hands of the public.

Total subscriptions of all kinds for war savings certificates are now averaging over 1,000,000 per month; the average monthly subscription is about $7. The announced goal is to raise $120 million per annum. It must be remembered that these war savings certificates are being bought by the same people who, if their weekly income is over $23 if married or $13 unmarried, are paying 5% or 7% of their total income under the national defence tax, and who have also commenced this year to pay unemployment insurance contributions.

Having surveyed wartime expenditures, taxes and government borrowings in Canada at the present stage of the war effort, it remains to point out that strictly fiscal measures are becoming less and less important. Present measures must, of course, be maintained. Taxes might even be further increased to a certain extent, and it seems likely we shall have more and larger war loans, but

on the whole fiscal policy has done about all that it can do. The rest of the job requires, as times goes on, more and more reliance on other economic measures, and particularly on direct controls in the fields of production, distribution, consumption, prices, wages, and generally in the allocation and use of specific resources for specific uses.

For the prevention of general inflation, price control is an inevitable adjunct of fiscal policy, once a certain stage has been reached. So far, actual control has had to be exercised only over a few specific commodities, sometimes, on a temporary basis, but the object is and must be to prevent the general price level from rising too much, if not from rising at all. During the first two years of war a number of maladjusted price-relationships have been straightened out, chiefly by rises in prices which were comparatively depressed. A new equilibrium more suited to wartime conditions and to a state of full employment seems now to have been reached, and a greater degree of control will obviously be necessary to maintain that equilibrium on as stable a basis as possible.

Control of the cost of living is impossible without a considerable measure of stability in wage rates. The heavy taxation of profits, and the high degree of wage adjustment already effected, have brought us to the stage where any further increase in one man's wages means a corresponding increase in another man's cost of living and leads to endless further changes in wages and prices. The government's policy that basic wages may, if the particular circumstances warrant, be as high as the maximum from 1926 to 1939, but no higher, has been pretty generally accepted in public thinking and is the governing factor, though not actually compulsory, in basic wage adjustments. Protection against rises in the cost of living is afforded by a system of flat-rate cost of living bonuses.

Of equal importance is the method of allocating goods available for civilian use after war demands at any particular time have been met. The problem of shortages is rendered more acute the more effective the control of prices, and the two problems must be considered together. When a specific shortage becomes too great, rationing of supplies to producers or consumers is the ultimate implement of economic policy. Voluntary campaigns can sometimes work wonders—in Canada the public voluntarily reduced consumption of bacon and gasoline by substantial amounts—but that method is only successful within certain limits and there are fields where it is not suitable. The imposition of specific controls going far beyond the influence of fiscal policy becomes progressively more important.

Such controls have already become familiar in Canada. Civilian use of scores of raw materials has been virtually prohibited or severely restricted by rationing supplies to secondary producers; for example, silk, aluminum, steel, zinc, and various other base metals

and chemicals. Machine tools have long been on the restricted list, and special permits must be obtained for nearly every kind of construction project or installation of machinery and equipment for non-war purposes. Gasoline consumption has been reduced voluntarily, and rationed on a monthly basis to distributors; automobile production has been progressively curtailed for some time, and, by January, will amount to less than 44% of 1940 production; radios, refrigerators, washing machines and other similar articles are now restricted to 75% of 1940 production.

It is the extension of measures of this sort which will test the effectiveness of national defence financing in the broadest meaning of the term, as the manpower and economic resources of a nation are increasingly diverted to the prosecution of the war. There can be no doubt that the Canadian people are determined to do everything in their power, and to sacrifice whatever may be required of them to assist in the destruction of Hitlerism. The increasing need for what appears to be regimentation, the extension of government regulation and control throughout all the activities of the nation, does not mean the disappearance of democracy, but is rather a sign of the increasing efficiency of a democracy in a job which is foreign to its nature, that of wilful destruction. In the process many people are realizing the tremendous productive resources which for years lay available but unutilized, and we may be sure that when peace is won we shall return to the democratic exploitation of those resources for constructive purposes on a scale never before thought possible. That, however, is a thought to comfort us in moments of relaxation; for the time being, there is only one task, which must be finished before any others may be undertaken—the final and utter destruction, at whatever cost, of those who would destroy us or compel us to remain indefinitely in the undemocratic condition of an armed camp under unending strain and privation.

CHAIRMAN LELAND: That I believe was a delightful summary of what has been happening next door. In order that Mr. Poole may be able to catch his train, and with the kindness of Mr. Thomas, I have arranged to shift the next two speakers. That suits me to a T, because I would like to see Germany finished, and then consider the problems of Great Britain. I wanted you to be quite sure that I was impartial on this subject.

The next speaker, then, will be Professor Kenyon E. Poole, professor of Brown University, now on leave with the Treasury Department. I am sure many of you are familiar with his excellent study on these finances of post-war Germany, and if you haven't seen it or read it, you can well afford to do so.

It gives me great pleasure to introduce one of our American students of German finance, who will carry on the discussion of trends and policies in Germany.

KENYON E. POOLE: As a matter of fact, it turns out very well that I follow Mr. Bieler, because he mentioned the fact that the next step in Canada will be the use of more direct controls. It is exactly that subject which I am going to examine here, and, incidentally, from such a point of view that it may be disappointing to some of you. It is impossible to summarize the German financial system in twenty minutes. You can say that of any country, but there is one special reason in this case, and that is, so many measures have been taken for the purpose of taking care of a special situation. It is difficult to generalize on that, and so I am going at it from a different point of view. I hope you will bear with me if this at times gets a little disconnected, because this paper can't be read in twenty minutes, and I am going to telescope at times.

GERMAN TAXATION UNDER A SYSTEM OF CONTROLLED PRODUCTION AND RATIONING

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Fundamental changes in the role of governments in economic affairs during the past decade have given rise to substantial alterations in systems of public finance. Events have developed so rapidly that the struggle between established views and untried ideas has become academic. Even the conservatively inclined begin to recognize that the pressure of circumstances requires greater and greater reliance on methods which are uncertain in economic effect, and which may be vulnerable to political abuse. At present there seems to be no possibility of evolving a new generalized basis for fiscal policy. Indeed, it does not appear that such a development would now be desirable. Imagination would be stifled when it is most keenly needed, and a rapidly changing situation would make the system almost at once obsolete.

In these circumstances it is natural that information should be sought concerning the methods and success of the nations that have been forced to make greater use of new paths in taxation and expenditure policies. This paper is devoted to an examination of the experience of the country which has gone furthest in the application of novel ideas, namely, Germany. Although it will transpire that much of what Germany has learned is not likely to be directly relevant to American fiscal problems, the desirability of achieving a working knowledge of her fiscal system is obvious.

German financial observers stress the novel features of recent legislation in the field of public finance. The following quotation from the *Institute for Business Research* expresses the current view:

> "The conversion of peace-time production into an efficient war-time production is no longer carried out by monetary measures, but by direct regulation of production and by rationing. In other words, if the Reich raises additional taxes and credits, it does not primarily do so for the purchasing of war material. Additional taxes and credits are only the monetary counterpart of the extension of production for war purposes already achieved by direct means. War financing today means first of all the maintenance of economic order by adapting the monetary part of the national economy to its productive counterpart." [1]

Not only has taxation recently been forced into the mold of rationing, but other non-revenue objectives have assumed prominence. These have, however, all been added to an already developed tax system. Consequently, in order to gain an adequate conception of the relative importance of the new objectives of tax and loan policies, it is necessary to understand the background against which recent changes have been made. After a brief description of the tax system as it looked up to about the commencement of the war, we shall turn to a consideration of what the Germans believe to be their peculiar contribution to practice in public finance.

The development of German taxation in the past decade falls into three main parts. The first is the tax system as it was received in 1933 by the Hitler government; the second embraces the years of recovery and rearmament, and is brought to a close by the achievement of full employment with its attendant scarcities of factors of production and commodities; the third relates to the period still continuing, when the problem is substantially one of overcoming scarcities.

The prostrate condition of Germany in 1931 and 1932 forced the Bruening and Papen régimes to make use of a large variety of taxes, at very high rates, in order to meet the costs of government. The period 1930-32 saw the introduction of the following new Reich taxes:

1. The Crisis tax (¾ to 4% on incomes over 16,000 RM);
2. Unemployment relief tax (1.5–6.5% on wages and salaries);
3. Property tax (0.3–0.7% on real and personal property, graduated);
4. Industrial charge (0.45% on working assets over a half million RM);
5. Turnover tax (at the onerous rate of 2%);
6. An increase in the automobile tax;

[1] *Weekly Report*, September 5, 1940. Reference in this quotation is to a combination of loan and tax policy. In what follows tax policy is considered first.

7. Miscellaneous taxes on circulating capital, stock transfer, etc.;
8. Miscellaneous increases in rates and number of excise taxes.[2]

These new taxes were added to a system which already has made considerable use of consumption, income, and business taxes, and clearly brought the system to a point at which rates and number of taxes were extremely burdensome. The National Socialist party made no effort to reduce these taxes substantially, nor did it attempt to introduce any new philosophy of taxation. Feeling greatly in need of revenue, the new régime made only minor reductions, which were partly intended to stimulate employment, and partly to fulfill certain political objectives, such as the stimulation of population growth. Despite the failure of the Hitler government to reduce the high rates of earlier years in the face of a rising national income, revenues proved insufficient, and some increases were made for revenue purposes.

The changes during the second period (which draws to a close toward the end of 1937) were not great. Those which occurred, though partly intended to bolster revenues, were to a considerable extent designed to implement political aims. Thus the income tax, which had been graduated up to 40%, with an average addition of 10% of the tax for single people, was advanced to a top rate of 50% for single people; at the same time, however, the various crisis taxes were removed. A special defense income tax for two years of 50% was levied on those born after December 31, 1913, who had not been called to military service. Taxes on wage-earners had been raised substantially; adding "voluntary contributions", the rate for even low brackets was over 10%, and for very low incomes, well above that. Alleviations to the income tax were admitted through exemptions for the hiring of servants, and miscellaneous concessions were made to various groups (especially government employees). Finally, the corporation income tax was raised from 20% to 30%, and the salaries of directors were made subject to a tax of 10%.[3]

By 1938 two new phenomena, both aspects of the same problem, began to offer difficulties. Full employment of resources was becoming a reality; and successive attempts to divert greater amounts of savings into the military effort began to meet increasing obstacles. The time had come when a much closer control was necessary than had hitherto been exerted. Yet of the changes in the tax system in this third period, those designed to produce added amounts of general revenue still predominated. Other objectives were added, however, and it is clear that definite attempts at control were being made. The main changes from shortly before the commencement of the war to the present are as follows:

[2] As of January, 1933. *Tax Systems of the World* (1933), pp. 94-95. Qualifications, exemptions, and special cases are omitted above.

[3] *Tax Systems of the World* (1938), pp. 298-299.

1. Further increases were made in the wages tax (lower incomes became subject to the tax);
2. Bachelors and childless couples married five years were subjected to increased rates;
3. Under the New Financial Plan a special income tax provided for a 30% increase in the rates applicable to incomes over 3000 RM per annum. (This was the "Income Increment Tax", introduced to compensate for loss of revenues under the Tax Certificate plan, which is discussed below. Later the exemption was increased to 7200 RM and the rate was reduced to 15%);
4. Exemptions earlier introduced to encourage employment were removed (e.g. the exemption for employment of servants);
5. At the beginning of the war a special war surtax of 50%, applicable to incomes over 2400 RM per annum, was enacted. The surtax was not to exceed 15% of total income, and all income taxes together were not to take over 65% of net income;
6. Beer and tobacco were subjected to a 20% war surtax; rates on champagne and spirits were also increased;
7. The corporation income tax was raised from 30 to 40%. Recently (August 24, 1941) corporation taxpayers have been granted a small relief because it is believed that they ought to be allowed some scope for building up reserves against their postwar tasks. In order to avoid the dissipation of these sums, the remission was made applicable only to (a portion of) those profits which are kept in the business until the end of the war.
8. A special war contribution was required from the states and towns, on the ground that Reich war expenditures reduced the needs of the local bodies for revenue. Also, public corporations were required to pay taxes to the Reich. The beer tax had been consolidated in July, 1938, and most of the proceeds turned over to the central government.[4]

Granted an increasing emphasis on tax measures which reflect production and consumption policies already determined upon by

[4] Obviously it is not possible to be dogmatic on the question whether the above taxes are mainly for revenue or for control of production and consumption. The increases in the wages tax were probably intended to remove all purchasing power of the masses above what they could currently use under the rationing scheme. The increase in the beer and tobacco tax would appear to have in part the same objective; but at the same time the advantages to the Treasury of such high taxes on articles of inelastic demand is clear. The corporation tax, to be sure, looks like a revenue tax, since firms were already strongly urged to invest their savings in government obligations. Increases in the income tax, especially in the upper reaches, did not go far enough to be regarded as substantially more than a means of finding more revenue.

the control authorities, it remains to be considered how consistently the new policy has been carried out, and whether the statement is strictly true that "additional taxes and credits are only the monetary counterpart of the extension of production for war purposes already achieved by direct means." [5]

In order to test the truth of the statement quoted above from the Institute, answers to the following questions are required. First, what is involved in the achievement of an exact correspondence of financial (tax plus loan) policy with control of output and consumption? Second, to what extent have decrees governing the distribution of resources and commodities been followed up by complementary tax and loan measures? Third, what is the proper relation of tax policy to financial policy as a whole in achieving this correspondence with control of production and consumption?

The first question may be disposed of briefly. Taxes plus government borrowing must succeed in curtailing purchasing power (1) of producers to the extent that production is taken out of their hands, and (2) of consumers to the extent that they are denied access to goods and services. When taxes and loans add up accurately to accomplish this objective, financial policy is clearly subsidiary to controlled production and consumption.

The answer to the second question can only be given approximately. It may be said at once that German authorities have made every effort to divert to the Treasury all possible reservoirs of purchasing power. This was not all done at once; as classes of individuals and producers were discovered to be in possession of claims to goods, either special government issues were floated, or new taxes were thought up, in order to make use of these free pools of purchasing power. That even with the vaunted German controls over

[5] Another important subsidiary use to which the tax instrument has been put, but which can only be noticed in passing here, is that of subsidizing exports. The Export Subsidy Fund exerted a powerful effect on the course of international trade in the three years before the commencement of the war. In order to form a pool out of which subsidies might be paid to exporters, German firms were subjected to a turnover tax. The proceeds were added to the sums realized by buying back foreign-held German bonds after their price had been driven down by a refusal on the part of the Reich to permit free repayment. The tax instrument entered again when exporters who were allowed to buy back their foreign-held bonds at a discount were required to hand over a part of these windfall gains to the Export Subsidy Fund. This kind of procedure seems to be taxation in name only. Properly it is a rationing of funds among firms in such a way as to advance production and sales in desired directions.

An example of tax policy which bears even less relationship to domestic revenue requirements is the license fee of $4.50 per 100 RM for Travel marks, and $3.35 per 100 RM for "Benevolent" marks, the proceeds of which are deposited in a special (blocked) dollar account in this country earmarked for payments to Standstill creditors. Here is a striking example of Germany's ability, through a strategic bargaining position, to extend control to individuals resident in other countries.

production, consumption and investment, however, complete success has not been achieved in forcing capital into public loans, is evidenced by the complaint of Wilhelm Zangen, chief of the Central Organization of German Industry. He attributes the "unhealthy level" of stock prices to the practice of those producers who are unable to replenish inventories, or replace equipment, of putting the released funds into the stock market.[6] Again, there has been considerable complaint that some firms are still financing themselves out of profits, a practice which is inconsistent with a completely controlled economy. Despite the leakages, however, it may be conceded that in Germany the combination of loan and tax policy fits very closely into the system of controlled production and consumption dictated by the military effort.

A satisfactory practical answer to the third question is difficult to find. The problem may be looked at from two points of view: (1) from that of claims on capital, and (2) from that of the rationing of goods. With respect to the first, it is clear that individuals and firms ought to be allowed to save only as corresponding real assets come into being. But when a nation is engaged in conflict, the meaning of real saving becomes obscured. Much capital consists of military weapons, the value of which cannot be assessed; and large amounts of ordinary plant and equipment may be destroyed. In view of the enormous cost of modern warfare, the question must be asked, How far ought monetary savings to be allowed? If victory were a certainty, the claims of bondholders could be satisfied by seizure of enemy property, and the problem would not arise. With the information ordinarily in possession of the authorities when war is undertaken, however, it appears that the costs ought to be met entirely, or at least very largely, from taxation of income ordinarily saved, plus the sums released by the curtailment of consumption.

Controlled production and rationing bring us to a similar conclusion. Granting a policy of rationing for all members of the community, it follows that taxes alone should accomplish the diversion of purchasing power to the state in accordance with control of production and consumption. The enormous difficulty of such a procedure is manifest; taxes must take all income which because of rationing cannot be spent; yet this is not possible in a capitalist economy, because it involves confiscation of incomes above a level of consumption established for all. In view of the impossibility of attaining the ideal, it is of interest to discover what success Germany has had in trying to achieve it.

The most direct way to approach this question is to attempt to decide whether and how far tax decrees were calculated to accomplish the objective outlined above. The conclusion follows quickly that increases in rates have been made for the most part independ-

[6] *New York Times*, July 22, 1941.

ently of any attempt to control production and consumption. With certain prominent exceptions, they have been of a general type (e.g. the 50% increase in the income surtax at the commencement of the war), and on the whole have not given the appearance of being specifically directed at removing the particular reservoirs of purchasing power released as a result of planned production and consumption. There appear to be three reasons for this. First, the Reich needs revenues, and the immediate problem is to get them. Second, taxation is a difficult instrument to use when purchasing power of special individuals and classes of individuals requires to be curtailed; any single, specific decree involves flagrant discrimination, even though all taken together represent equitable treatment for the whole community. Third, control of production and consumption is satisfactorily reflected in government finances if taxes and loans together equal the value of the goods and services diverted into government hands; the much more difficult problem of adapting tax policy to such control is likely to be, and so far always has been, left to a later time.

A brief evaluation has been presented of the claim made by the Institute with respect to the significance of recent fiscal policy in Germany. We conclude that although it is essentially true as stated that taxes plus loans have reflected controlled production and consumption policies, the same can not, but ought to be, said of tax policy alone. In the lower income and wage brackets, high taxes and "voluntary" contributions have gone far to take definitively from individuals that purchasing power which would have been directed at commodities had they not been restricted. But for those in the higher income brackets the same situation does not obtain. The changes in the income tax law made at the commencement of the war left the system as a whole still favorable to the wealthy. Though denied access to the goods and services in substantially the same manner as the lower income groups, they have been left in possession of a substantial part of their claims; and indeed, inability to consume at the old rate has given rise to a greater volume of savings on their part than formerly.

II.

Thus far emphasis has been laid on the nature of the relationship between the diversion of resources into the military effort, and the tax and loan policies of war finance. It remains to indicate the manner in which financial policy may carry tax policy along in its wake, with the result that there is added to the framework of independent tax laws a superstructure of tax measures which have arisen to cover specific loans and "bridge" credits. Normally, government loans do not give rise to specific tax laws; the loans are expected to be paid back out of general revenues over a period of

years. But the practice of anticipating taxes, and issuing short-term credits in such volume that consolidation becomes increasingly difficult, tends to encourage the enactment of specific covering taxes.

Taxes enacted for this purpose give the tax system a rather deceptive aspect of originality. In large part such "improvements" are actually of merely superficial significance. No new sources of revenue suddenly appear which otherwise cannot be tapped, although it is true that an excuse is sometimes provided by this procedure for introducing taxes which might otherwise be impossible for political reasons. Again, no special significance, beyond the political, attaches to the practice of earmarking new revenues to cover specific loans. Finally, the whole practice can be so complicated and expensive, because of administrative costs and concessions to taxpayers and holders of the financial instruments, that rather than an advance in technique it represents a step backward in government finance. At any rate, it must be concluded that tax innovations evolved from this practice are not likely to be directly useful to countries which do not resort to a linking of government borrowing to specific tax cover.

Although the German practice of anticipating taxes became expensive and unwieldy, and was finally abandoned in favor of the earlier system of short-term loans, it is nevertheless useful to examine this method of financing, both for its own sake and in its relation to the tax system during the period of its operation.

The tax certificate has been the chief instrument employed by the financial authorities for the purpose of subordinating tax legislation to loan policy. First devised under the Papen régime, the certificate was originally intended to encourage greater production through the remission of taxes, while at the same time keeping revenues at the former level (or in so far as the program was a success, increasing them) by allowing those who paid the taxes to recoup themselves by selling the tax receipts in the short-term money market. Although observers in Germany pronounced the Papen plan a failure, the Hitler government decided to exhaust the possibilities of the tax certificate in another set of circumstances.

Before reviving the tax certificate idea, however, the government made use to a very full extent of the method of financing government expenditures by short-term bills; this scheme, employed from 1933 to 1938 for civil and military public works, made it possible for public agencies to issue bills, discountable at the Reichsbank, the proceeds of which were to be used on the given building project. Although technically liquid, these bills were renewable for long periods, and individuals and institutions became loaded with larger and larger amounts. In order to restrict their price inflationary effect, every effort was made to relieve the Reichsbank and its subsidiaries from the necessity of holding these bills; in fact, however, private savings did not suffice to absorb them all, although these

banks in the main provided only transition credits. During 1934 and 1935, when rearmament came out into the open, these bills gave place to a similar instrument called "Special bills".

In 1938 the special bills were abandoned in favor of "Delivery Bonds" or "Certificates", which were intended to place a measure of control over the rate at which short-term credits were being created. By this time it was becoming obvious that unused resources were being reduced to the point where the system of price and wage control would soon be threatened. For a time, apparently, the authorities thought mainly in terms of financial devices; it was believed that as each new instrument was developed, adequate new reserves of purchasing power would appear. But with virtually full use of resources these could be of significance only if individuals and firms withdrew still further. It was the failure to bring about a sufficient transfer of real resources which necessitated the repeated introduction of new financial devices after the preceding one had accomplished all that it could. Although it seems clear that rather more dependence was placed on financial devices than was justified, it must be conceded that each of these credit instruments played a part in absorbing purchasing power which had hitherto been left in private hands.

The delivery certificates, which enabled certain governmental services to issue six months' certificates of indebtedness as part payment for materials and services rendered them, were merely a government obligation issued directly by the agency. Simultaneously, greater stringency was placed on private issues. The situation created by the delivery bonds, however, proved to be untenable. From the point of view of the allocation of resources, it proved inadvisable to dry up entirely loans to private concerns which are only indirectly important in the military effort, as well as to the non-military branches of the government, for example the postoffice, public administration, and railways. On the financial side, the delivery bonds were an unstabilizing influence; because of their short maturity the consolidation of loans was hampered, and they exerted an adverse effect on bond rates. They were therefore given up in the spring of 1939, and replaced with the Tax Certificate.

From the point of view of the effect of financial methods on the tax system, there is a sharp line between the special bills and the delivery certificates on the one hand and the tax certificates on the other. The former were intended to circulate for a time, and then either be converted into longer term debt, or retired through new loans. The latter, representing the anticipation of taxes, led directly to tax decrees for the purpose of redeeming the certificates. For a period, however, the instruments might be expected to operate in much the same manner. Therefore, although the introduction of the tax certificate was heralded at the time as a signal that the Reich was going to get out of the market for capital, it was not apparent

how this was to be accomplished in view of the admitted necessity of maintaining the rate of expenditure.[7] Granted that the economic system was operating already at full speed, nothing could be done to increase the availability of real resources unless consumption outside the military establishment was reduced. Although increasing difficulties with successive financial plans called for a more rigorous system of rationing, it was decided again to postpone facing the problem by issuing certificates.

The tax certificate was a modified version of fiat currency. The Reich was to pay 40% of its debts to business in tax certificates, and business in turn was permitted to pay 40% of its debts in the same way. But the legal tender aspect of the instrument was limited to dealings between the government and business and between concerns. Because the certificates, later redeemable in payment of taxes and customs, were not allowed to enter into the personal income stream, no danger existed that individuals might attempt to get out of money into commodities; thus although shortages might develop, or price control might be subjected to pressure, hyperinflation would be avoided.

The way in which the new plan was designed to work out was evidently unclear to German financial experts, who understood that loans have to be reflected in real goods. The following statement from the *Weekly Report* is illuminating of more than one facet of the situation:

> "For the new finance plan as before prevails (sic) the principle that a credit expansion is economically justified only when there is a corresponding expansion of production. The credit expansion effect of the tax credit certificates is in a certain sense justified *by the fact and to the extent that* the new economic territories offer possibilities for production expansion." [8]

Apparently German observers saw little opportunity for further expansion within the Reich itself; thus the choice of financial methods reflected decisions already made with respect to international relations.

In the event of a long war, with its attendant destruction of resources, this method could not survive. Therefore Finance Minister Reinhardt announced that the issue of the new tax certificates would be discontinued if the war became general. They were in fact given up on November 1, 1939, and since April 1, 1940 business men have no longer been allowed to make use of them for payments. The older practice of issuing bills and short-term loans has been resumed. Although this did not do away with the problem, it did represent the abandonment of an unnecessarily complicated method of finance.

[7] Institute for Business Research, *Weekly Report,* April 20, 1939, p. 4.

[8] April 20, 1939, Supplement, p. 4. Italics mine.

Despite the short life of the tax certificate plan, the relation of the certificates to taxation, investment, and commercial policy is worthy of notice. The certificates were of two kinds, called Type I and Type II, and were issued by the Reich in every case in two equal parts. The objectives of Tax Certificates I, which represented the short-term portion of the debt thus incurred, were extremely complicated.[9] Nominally these certificates were acceptable at their face value for the payment of Reich debts six months after issue. Actually the business man was encouraged to hold them for a longer time by being rewarded with the privilege of taking more rapid depreciation of his assets for tax purposes. The longer the tax certificates were so held, the greater the amount of depreciation which could be taken. Thus if the certificate was held for one year, the additional depreciation allowed was 20%. This percentage rose by stages until by the fourth and fifth years the additional depreciation allowance was 35%.

In an apparently misguided attempt to bind together normally unrelated policies in order to obtain maximum results in the interest of a concerted war effort, the authorities attached the following feature. For firms exporting more than 25% of total sales, the depreciation allowance was increased by 10 points. Thus the widespread system of export subsidies was allowed to reduce, for a time at least, the yield of the profits taxes.

A new extreme in complexity was reached in the operation of Tax Certificates I. Quite clearly the expense of this plan was great, and it seems equally evident that the results must necessarily be unpredictable and diffuse. Although space does not permit us to devote extensive consideration to the ways in which such a plan might operate, one or two points may be made with the object of emphasizing the difficulty of controlling it properly. At first glance, tax remission to encourage the holding of government debt appears to involve merely a shuffling about of financial resources. Since it could scarcely be expected that military expenditures would soon decline, anticipation of revenue in this way would seem pointless. The depreciation clause complicates matters, however. If in taking advantage of this clause a manufacturer takes the entire depreciation on his plant in two or three years, the time is advanced when he will be unable to take any depreciation at all for tax purposes, unless

[9] Tax Certificates II were simpler. It was intended that these should be held for a longer period; they were not redeemable until 37 months after issue, but as compensation for this delay, they were acceptable for payment of Reich taxes and customs at 112% of their face value. While the tax advantages of the first type of certificate made them useful to the business man, it was expected that *banks* would find the second type a satisfactory kind of investment because of the interest accrual. Also, it is pointed out in the *Weekly Report* (August 11, 1939, Supplement, p. 3) that Type II can be used as second grade collateral for rediscounts (although they are only rediscountable up to 75%, and only on short term).

he undertakes new investment.[10] Thus, at constant rates of tax, no taxes are remitted at all (except in so far as the deferment of taxes represents an interest gain), and in the event that profits taxes are graduated, ultimately more taxes will be paid than would be the case in the absence of the plan: once all the depreciation has been taken, the firm finds itself thrown into the higher tax brackets.

The tax certificate affected the revenue system in two ways. Since it was receivable for Reich revenues and customs at an unpredictable time, depending on a variety of factors relating to investment conditions, future revenue receipts were to that extent left in doubt. Again, in order to compensate for the anticipated loss of revenues as the tax certificates began to be paid in for taxes, a tax was introduced on "increased income". Applicable only to incomes above 3,000 RM a year, and to increases of income greater than 600 RM, a 30% tax was to be levied on increases in income over the year 1937 after deducting the 600 RM exemption.[11]

The outstanding feature of a plan such as this is that all parties are befogged in uncertainty. The Treasury does not know the probable effect of the scheme on income, and consequently on tax receipts; nor does it know beforehand the cost, in terms of revenues lost, of the financial instrument chosen. The business man is required to add to his usual problems uncertainties as to when to undertake investment, what depreciation policy to follow, the duration of the war, and the effect of governmental policy on his ability to carry on business at all. Clearly ingenuity has here been carried to a point where its most obvious characteristic is the lack of a thought-out, consistent, and integrated plan; and the *ad hoc* tax measures resulting from a mixed policy of this kind are not likely to prove applicable to the situation in any nation operating under another philosophy of fiscal policy. Our conclusion on German financial and tax policy during the past several years must be that although much has been learned regarding techniques which is bound to prove useful to the United States, each separate measure has been so much a part of an amorphous group of decrees intended to implement a wide variety of objectives that transplanting would be inadvisable.

[10] This would be discouraged or even prevented unless the firm were engaged in activities connected with war.

[11] Institute for Business Research, *Weekly Report*, April 20, 1939, Supplement, p. 4. Exemption of civil services and agriculture from the tax appears to reflect political pressures. Further compensations for the drop in revenues were to be found in savings on administration, and in a hoped-for further increase in the tax base brought about by a continuing increase in output. The rate of this tax was later reduced to 15%, and the exemptions raised. Reichs-Kredit-Gesellschaft, *Economic Conditions in Germany in the Middle of the Year 1939*, p. 59. It was finally repealed.

CHAIRMAN LELAND: That was an example of a whole series of horrible financial devices. I have long admired what Mr. Poole has written. I am even more pleased at the delightful presentation he has given us of that very complex topic.

We now turn to the last of our countries for consideration and evaluation, and after what I said before, I think I need say no more about our transposition.

The financing of the war effort by Great Britain will now be discussed by Mr. Brinley Thomas, of the staff of the British Embassy in Washington.

It gives me great pleasure to present Mr. Thomas.

BRITAIN'S TAX BURDEN COMPARED WITH AMERICA'S

BRINLEY THOMAS
British Embassy, Washington, D. C.

The question of the burden of taxation in Great Britain and the United States has recently been brought into the limelight through a widely quoted statement by the Chamber of Commerce of the United States that "the additional levies imposed by the Revenue Act of 1941 will bring the tax burden in the United States above that in Britain."

I propose in this paper to enquire whether there is any substance in this statement which, I am sure many will agree, does not on the face of it seem probable. However, statistics have been advanced in an attempt to demonstrate the claim; and I feel that it is necessary to look into the calculation rather carefully. I am not concerned with pre-conceived notions, but simply want to get at the facts.

The Chamber of Commerce analysis says that in the fiscal year ending June 1942 the national income of the United States will be \$90 billion and the amount to be raised in federal, state and local taxes will amount to \$22.5 billion. Thus the taxes paid will represent 25% of the national income. On the other hand, in the United Kingdom for the fiscal year 1941-1942, the national income, according to the Chamber of Commerce, will be \$36 billion and taxes, national and local, \$7.9 billion, so that taxation as a proportion of national income comes out as 22.1%. It is thus alleged that here in the United States the financial burden on the people is heavier than it is in Great Britain, by the difference between 25% and 22%.

May I say at once that, as far as I can find out, the figures of taxes to be collected, used in this calculation, are pretty near the mark. But the remarkable thing that emerges from the Chamber of Commerce statistics is that income per head in the United States is lower than it is in the United Kingdom: it is \$687 in the U. S. A.

compared with $783 in Britain. There must be something radically wrong with figures which yield this queer result. Everyone knows that income per head in the United States is the highest in the world. According to Mr. Colin Clark, Financial Adviser to the Queensland Treasury and a specialist on this subject, the real income per head over the period 1925-1934 (expressed, not in dollars, but in international units) was 1381 in the United States compared with 1069 in the United Kingdom. Surely nothing has happened since that decade to alter the fact that the United States, in terms of income per head, is the richest country in the world.

Since the Chamber of Commerce statistics have led to one result which is the opposite of the truth, it is clearly necessary to probe deeper to find out what has gone wrong.

Let us look at their figure for the British national income, which is 9 billion pounds, or 36 billion dollars. Is this a reasonably accurate estimate? It happens that for the year 1940 we have the most reliable estimate of the British national income ever produced: it is the work of the Central Statistical Office of the Government and was recently published in a White Paper entitled "An Analysis of the Sources of War Finance and an Estimate of the National Income and Expenditure in 1938 and 1940." According to this authoritative source the British national income in 1940 was 5.6 billion pounds or 22.4 billion dollars. Surely it is not reasonable to suggest that the national income of the United Kingdom is going to jump from 22.4 billion dollars in the calendar year 1940 to 36 billion dollars in the fiscal year 1941-1942. The most probable estimate for the British national income for 1941-1942 is that it will be between 6.5 and 7.0 billion pounds, or, say, 27 billion dollars. Thus British taxes will amount to 29% of the national income in 1941-1942.

Turning now to the United States, we find that the national income figure for the fiscal year 1941-1942 is given as 90 billion dollars. The level reached by the national income in the previous year 1940-1941 was 83 billion dollars. Now it is clear that the rate of industrial expension due to defence expenditure has been much accelerated recently. The index of factory employment rose from 103 to 125 between May 1940 and May 1941; factory payrolls went up from 98 to 142; while the index of durable manufacturing production which was 131 in June 1940 had reached 191 by June 1941. In other words, the United States is pushing on rapidly to the goal of effectively full employment. The drawing into employment of hitherto idle men and resources and the more intensive utilisation of existing equipment involve the production of substantially more real income. Given a national income of 83 billion dollars for 1940-1941, then, according to the Chamber of Commerce, the effect of this vast expansion in industrial activity will be to push the national income up to only 90 billion dollars. It will be generally agreed,

I think, among experts that this 1941-1942 figure is a serious underestimate.

Authoritative calculations lead one to the conclusion that the national income of the United States in the fiscal year 1941-1942 will be in the region of 100 billion dollars. Taxation as a proportion of this total works out at 23%.

The results of our analysis may now be put in the following table:

Fiscal Year 1941-1942

	National and Local Taxes ($ billion)	National Income ($ billion)	Taxes as % of national income
United Kingdom	7.9	27	29
United States	22.5	100	23

Thus, even if we regard taxes compared with national income as a complete indication of relative burdens, we reach the conclusion that the burden is heavier in the United Kingdom than in the United States. The unreasonable estimates of the national income in the two countries, which led the Chamber of Commerce into the fallacy of making Britain richer than the United States, were also responsible for the inaccurate statement that the tax burden in the United States is heavier than in Britain.

The Chamber of Commerce analysis also asserted that the tax burden *per capita* in the United States is greater than in the United Kingdom, namely, \$168 compared with \$165 for 1941-1942. But surely it all depends on what you mean by "per head". In a country fighting a total war a good proportion of its civilians are bearing arms and are therefore outside the circle of taxpayers. If one wants to know the burden of taxes per head, one ought only to include those who are engaged in producing the national income; to take just the population in the case of two countries, one of which is fighting, is to be guilty of not comparing like with like. If we took as our base the number of real income-producers in the two countries, it is clear that the effective "population" in the United Kingdom would have to be reduced in order to arrive at a proper basis for comparison.

This, however, is not the most important point. When you compare taxation as a percentage of the national income in the two countries, it does not really matter which sterling-dollar rate of exchange you use. Whether it is 4 dollars or 5 dollars to the pound, the proportions worked out would be the same. But when you come to measure taxation *per head* in U. S. A. and the United Kingdom, it does make a good deal of difference whether you express British taxes in dollars at the rate of 4 or of 5 to the pound. The rate of exchange applied by the Chamber of Commerce is 4 to the pound;

but no one can say at present whether this is the proper rate for this kind of calculation.

If we use a rate of $4.50 to the pound, the burden of taxes per head in Great Britain in 1941-1942 works out at 185 dollars compared with 168 dollars in the United States.

There are certain facts about the relative burden of income tax on the great mass of taxpayers in the two countries which deserve emphasis. The following table shows for a married person (with no dependents) the amount of Federal plus New York State taxes payable in 1941-1942, taking into account the recent increases, and the amount of income tax payable in Great Britain, at different income levels.

INCOME TAX IN U. S. A. AND U. K.

Married Persons (with no dependents)

Net Income before Exemption	U. S. A. & N. Y. State		Great Britain		
	Tax	Effective Rate %	Tax (before Post War Credit)	Post War Credit	Effective Rate (before Post War Credit) %
$ 3,000....	$ 152	5.1	$ 955	$160	31.8
5,000....	461	9.2	1,855	227	37.8
10,000....	1,631	16.3	4,505	260	45.1
50,000....	22,271	44.6	36,455	260	72.9
100,000....	55,271	55.3	84,080	260	84.1
1,000,000....	749,736	75.0	961,850	260	96.2

A married person (with no dependents) in U. S. A., earning $3,000, will pay $152, or 5%: in Britain, however, he pays $955, or 39%. If he earns $5,000, the U. S. Treasury and the New York State Treasury leave him with $4,539; but in England, after paying his income tax he is left with $3,145. And so it goes on, until we reach the income level of $1,000,000, where 96% is taken in taxation in England, compared with 75% in U. S. A. (The relatively small amounts to be obtained back in England in the form of post-war credits do not affect this calculation much.)

The taxes on spirits and cigarettes are considerably higher in England than in the United States. On spirits the British tax (per gallon) is $14.23, while the combined federal and average state excise tax in the United States, up to the 1941 Act, was $3.99. Similarly, on cigarettes, per thousand, weighing 3 lbs., the British tax is $11.70, and the combined federal and average state excise tax in the United States is $4.50. It is levies such as these that bring the reality of the burden home to the average person.

I have so far confined myself to the notion of tax burden in the narrow sense. I feel, however, that to be realistic one has to give the word "burden" its full meaning. The British people are sustaining their war effort, not only by paying taxes, but also by eating into their past savings. The capital of the country is being to some extent consumed to pay for the war. The above-mentioned White Paper estimates that the amount of overseas British capital mobilized to finance expenditure was 542 million pounds (2,168 million dollars) in the first year of the war, and 479 million pounds (1,916 million dollars, in the first half of the second year. The disappearance of these 4 billion dollars' worth of capital is a burden on the British people, since their standard of living ultimately depends on their productivity, which in turn is largely determined by the amount of capital per head. To recover capital which has been used up involves efforts and sacrifices which otherwise would not have to be put forth. And these should be added to the burden involved in paying taxes.

The notion of "burden" needs to be filled out in yet another direction. We have seen that the middle and lower income brackets in England feel the edge of the tax-gatherer's shears more keenly than their opposite numbers in the United States. But that is not all. Because of rationing and restrictions of all sorts due to war conditions, the money you have left after paying your taxes does not give you the same satisfaction as usual. So we have what I might term a "consumer's burden". The range of choice for the individual buyer has to be restricted: he can no longer enjoy the pleasures of purchasing in markets laden with a rich variety of commodities. There is physical control of supplies. This fact again is a real burden.

I, therefore, suggest in conclusion that financial burden on a people in war time involves not only the taxes they pay but also the capital they eat up and the consumers' sacrifices they undergo. There can be no question about the conclusion that the financial burden on the British people is considerably higher than the corresponding burden on the American people.

NOTE

Since this paper was written I have received the authoritative estimate of the British national income for the fiscal year 1941-1942 which puts it at 6 billion pounds, i.e., 24 billion dollars.

I also wish to point out that the above analysis did not allow for the fact that Pay Roll taxes are included in the Chamber of Commerce tax figures while they are not in the British tax figures. Furthermore, the War Damage Insurance premiums paid in Britain should be taken into account as part of the burden.

If all the necessary adjustments are made, the argument in the text is considerably reinforced. The authoritative figures are as follows:

UNITED KINGDOM

FISCAL YEAR 1941-1942

	Pounds (million)	Dollars (million)
Estimated Net National Income	6,000	24,000
Taxation: National	1,760	7,040
Local	220	880
Health, Unemployment and War Damage Insurance, and Contributory Pensions	420	1,680
Total Taxation	2,400	9,600

These authoritative estimates lead to the result that Total Taxation in the United Kingdom in the fiscal year 1941-1942 (i.e. national and local taxes plus social insurance and war damage insurance charges) represents about 40% of the net national income.

CHAIRMAN LELAND: I am sure you will all agree with me that we have had a most delightful morning. I would like to tell some stories on the statisticians, but I really think that would come as an anticlimax, and, besides, you have heard all the stories I can tell, anyway.

So the meeting is now yours for questions, discussion, and stories. We shall try to recognize all of you and see that in due season we explore this very delightful subject. I am quite sure that Mr. Thomas, too, will be glad to answer any questions that he can with reference to British financial policy, so that if you have any questions about what is being done, as well as the subject matter of his address, I am quite sure that he will do his best to explain to you the details of the fiscal systems, if you are interested in knowing of them.

Professor Lutz, I am glad to recognize you first.

HARLEY L. LUTZ (New Jersey): I should like to comment very briefly on two of these papers, the paper by Mr. Thomas and the paper by Mr. Sullivan. I hold no brief for the Chamber of Commerce. I think they stuck their necks out, as Mr. Thomas has very well shown. I should like to bring to the gentleman's attention, however, these points: in his comparison of the national income between England and the United States, as a result of which he got the British income up to some 27-28 billion dollars, and figured our own at something like a hundred billion, it may be that the Chamber of Commerce was taking into account some seven billions of Lend-Lease material that had been added to the British income

and subtracted from our own, in which case you get about 35 or 36 billions of British income.

In the second place, he made a very interesting suggestion that people serving in the armed forces should not be included in making per capita calculations. That seems a very reasonable suggestion. But I would point out that if you are going to do that in England, then you ought to subtract all the unemployed in the United States in making a similar per capita computation here. In other words, if you are going to subtract the men who are called to the colors, then I think you ought to subtract the men who are leaning on shovels.

The third point I would make with respect to his final observation, namely, that England is eating up her capital—well, I submit that we can give England big and little casino when it comes to eating up capital, and still come out very well in the comparison.

Now in a more serious vein, I should like to say something about Mr. Sullivan's paper. The first part of it, which dealt with the statistical summary of what has happened and what is likely to happen, was, of course, factual, and no question or argument can be raised with regard to it. But I confess that I felt considerable disappointment in the latter part of it, because of my realization that here was a pronouncement by the man who, as Dr. Blough says, is the final fiscal policy-making person in our governmental organization, I thought that part of the paper was extremely unrealistic. It was unrealistic because, in the first place, it gives us belated proposals for all our taxation. You remember that we are told we are to have another big tax bill next year. You realize, of course, that the full results of the present big tax bill are not going to come until 1943. According to that schedule, the full results of the next big tax bill will not come in before about 1944. I say that that shows an entirely unrealistic grasp of the fiscal necessities of the situation. It shows an unwillingness to consider effective means of siphoning off this surplus purchasing power to which Mr. Sullivan referred and of which we have all been conscious for a long time.

It showed, I think, a lack of realism in referring to a combination of all our taxation and of financing the loan part of the war through non-banking agencies.

If we are going to have genuinely all-out taxation, there isn't going to be a great deal left in consumers' pockets or in individuals' pockets for the purchase of saving or other defense bonds.

I suppose that some of you are aware that for many months I have been attempting to persuade the government of the country to adopt a truly realistic method of taxation, but with no success whatever. I might simply say this: that had we begun last December, when I began to talk about this, to consider such a method of taxa-

tion, we should now have many billions more in the treasury than we have, or are likely to get, we should not have the jitters about inflation to the extent that we are having them, and we should not be obliged to go to the banks for the type of inflationary borrowing which I think is inevitable.

I want to point out in that connection—and this supplements what the gentleman from Canada said—that the less we do in the type of taxation that is truly effective in drawing off the surplus purchasing power where it exists, the more we must do in direct controls. I hope he is right in saying that when this is all over we can throw off those controls, but I should like to point out to you that while that may be possible in Canada, it is likely to be, to some extent, wishful thinking in the United States, that we shall ever get rid of all those controls and therefore I feel the more disappointed—I might even say bitter—about our failure to use realistic taxation and effective taxation, that will get the money where the money is. Because the less we do in that direction, the more certain we are to be obliged to submit to these direct controls, a form of regimentation which would include not only price and wage control, eventually, but rationing and all the other forms of interference with personal affairs.

I think in spite of that it is likely to lead to the final result of an enormous mountain of debt. I am more truly worried about that than about anything else in our prospects, because an enormous debt, such as we are likely to have, in view of the fact that we aren't willing to face facts, is a short-cut to dictatorship — it is a short-cut to the loss and to the destruction of all those things that we are fighting for.

So I hope you understand that I have not said anything about Mr. Sullivan's paper in his absence that I wouldn't have said had he been here himself; but I trust that you get a little of the reaction that I feel toward the fumbling that is going on in the matter of our fiscal policy.

CHAIRMAN LELAND: Who is next?

SETH T. COLE (New York): Professor Leland, I wonder if Mr. Thomas would be good enough to enlighten us in respect to inflation control in England, whether there is any device affecting farm prices and labor wages?

MR. THOMAS: In regard to the two things you mention, the farm prices and wages, there is first the policy of the government, which is to subsidize the existing food price level, so that the amount which, say, millers have to pay in the market, which price, if it were projected into the internal price system, would be inflationary—the

difference between the price that the government wants and their costs, is paid to them in a subsidy out of treasury funds. So that it is not allowed to affect the price level in an inflationary way. That policy has great effect, and it is effective as a partial policy.

But with regard to wages, on the other hand, the trade unions have been taken into the confidence of the government, and trade-union leaders are part and parcel of the councils which are guiding the war effort. They are, as responsible people, bringing home to the members the dangers of allowing a wage spiral to plunge the country into an inflation spiral. I think that the influence of Ernest Bevin, who is head of one of the most powerful trade unions, as Minister of Labor, and believes in maintaining the structure of collective bargaining, on the labor question, is enormous. If I had the figures here, I could show you that the amount of disputes, time lost through disputes, has gone down to a very low level indeed—not through dictatorship, not through the trade unions being ordered, but because of the fact that their leaders inside the machine running the war effort, bring back to their members the situation as it is, with the result that actually the wage rates have not increased as much as you would have expected in view of the fact that there is full employment.

There have been, of course, certain increases in various scarce labor types, but not a general wage increase which you would have expected.

Frank E. Seidman (Michigan): I wonder whether Mr. Thomas would outline to us the forced saving plan adopted in Great Britain, and also whether he has taken into consideration in his figure with respect to the ratio of taxation to income in England the fact that a portion of those taxes, both income taxes and excess profit taxes, represent deferred savings to be returned in the future.

Mr. Thomas: The answer to the first question is this: that in the budget introduced by Sir Kingsley Wood last April, he increased the income tax on the very low income brackets very much, but he sugared the pill by saying that "these increases that I have to put on you will be obtainable in various rates on various income brackets after the war in the form of a post-war credit." I have the figures in my brief case there, if you want them, afterwards — the actual income bracket figures.

Secondly, the excess profits tax in England, as you know, is 100 percent. That means that companies having chosen their pre-war standard are not allowed to make a cent more profit than they did then. That is what we call taking the profit out of war. It takes it neat. If you want to take profit out of war, just say that no company shall make more profit than it did before the war. That

is what we have done. There are hard cases, but still there are always hard cases.

But in the latest budget, the Chancellor has said that a percentage of the amount paid by companies today on excess profits or on national defense contribution would be available to them after the war, also in the form of a post-war credit. I am not sure whether it is 25 percent, whether it is 20 percent, or 30 percent. It is one of those.

MR. SEIDMAN: 20 percent.

MR. THOMAS: 20 percent; thank you. 20 percent of what is received by the Treasury would be made available to the companies, as soon as the war is over, and of course it will have the effect of making available working capital for the industrial system which will have been geared to a total war.

I think the last part of your question was—

MR. SEIDMAN: Whether you took those factors into consideration in arriving at the total taxation.

MR. THOMAS: Well, as to the total tax, I hadn't much time; I have given the Chamber of Commerce the benefit of the doubt as to the British tax-collected figure, without going very much into it. The case is pretty easy, anyway. I didn't want to push up the tax-collected figure as well. But, actually, I think there that the amount to be obtained by the Treasury in excess profit tax in '41–'42, which is very big, of course—very big indeed—is in; I hope it is in. If it isn't in, then, of course, my case could have been even stronger.

CHAIRMAN LELAND: Surely you are not through?

HAROLD M. GROVES (District of Columbia): I would just like to ask a question with regard to how the social security taxes are treated in these comparative analyses?

MR. THOMAS: What do you mean by social security taxes?

MR. GROVES: I mean payroll taxes in the United States and their equivalent in Great Britain.

MR. THOMAS: Well, we have no payroll taxes in the United States sense of the word. The comparable tax which we have, if you care to make unemployment insurance deduction—yes. Well, they, of course, are not included in the British computation. The amount the employer pays, the amount the worker pays, into a social insurance fund, in respect of unemployment insurance, health insurance, and old age pension contributor schemes, are not included in the British. You have given me an idea. They are not included

in the British, since we have a far more elaborate system than you have.

Of course, in Germany — if Mr. Poole were here I am sure he would agree with me — one of the adjuncts of German financial economy has been to make you contribute for the people's automobile, and then they get all the money into the people's automobile, and then they produce tanks. They say the people's automobile will be available when they have won the war.

They treat the social security taxes the same. In Germany the workers are still paying the same contribution for social insurance as they did in the depression of '32–'33, if I am informed correctly, which is, of course, just a brand of taxation.

MR. LUTZ: I could give you another point, Mr. Thomas, on that. That figure of 22½ billion looks to me as if the Chamber of Commerce people must have taken seriously all of the talk that we have had about the present revenue bill producing three and a half billion dollars in the present fiscal year. As a matter of fact, it won't produce that much by 40 percent. But there is another billion-odd that they have in that 22 billion that shouldn't be there.

MR. THOMAS: Mr. Chairman, I am very grateful to you for the remark you made, because it confirmed a point which I had not considered as to the actual availability of the taxes within the fiscal year '41–'42. While I am sure you will agree with me that so far as the fiscal year '41–'42 in England is concerned, they will be available. But if it is not certain whether the taxes will be available wholly in the United States within the same fiscal year, well, there, again, you see there is another minus we have to take into account.

While I am on my feet, may I just comment briefly on two points Professor Lutz raised. I am afraid, owing to my having a very interesting conversation with my friend here, I missed the first point. I hope, if you want to, you will fill it in. But the second point, about the unemployed, that they should be left out—well, of course, I don't know where we are going to stop with this principle. Are you going to leave unoccupied women out of the population? And so on. But I think that while there might be a matter for discussion here, I think that there is a sharp distinction between a country which has mobilized part of its population to bear arms; I mean men who normally earn incomes, and good incomes, are now in the army, and they are not taxed, though the income that they used to earn is being earned by somebody else, but the somebody else is paying the taxes.

As to the other point about capital consumption, well, of course, far be it from me to venture into the dangerous pool regarding

capital consumption in the United States. All I have to say here, sir, is this: that I am afraid I must very respectfully disagree from our friend in regarding the present level of the national debt in the United States as leading you to the brink of disaster. The reason for that is simply this: that our national debt in Britain before this war was something over seven billion pounds. The national debt here has been coming up to about 45, hasn't it — 45 or 48 billion?

MR. LUTZ: 61 in '42, I believe.

MR. THOMAS: Yes, it is going up. Say it is fifty. If you work it out as a percentage of the population — I think one can do it, roughly—there is a vast disparity still between the per capita national debt in the United States and the per capita national debt in the United Kingdom, before this war started. Therefore, I think that since Britain on the eve of this war was not really plunging into a dangerous state, as far as this was concerned, we were in no danger of becoming a dictatorship. I know that the constitutional position has been brought up, and there are various problems.

I know that I am on very thin ice in raising this question, but all I am saying is this: that if you compare the national debt in England before the war with the national debt in the United States before the war, there was a big difference per capita. I say that what has been happening in England since has pushed up our national debt, and what has been happening here has pushed up your national debt, so that we are relatively more or less in the same position. I don't think it is a dangerous situation.

MR. LUTZ: I don't want to make you feel bad and spoil the rest of your stay in the United States by telling you what I think is going to be the situation in England and her debt after the war is over, so I won't say it.

CHARLES W. GERSTENBERG (New York): I don't think any story has been told. It is very nearly 12 o'clock. Mr. Thomas's theme song, "Yes, We Have No Bananas," reminds me of the story of Daniel Webster and Rufus Choate. One had to prove in a tort action that a cartwheel was round, and the other, that it had a little flat spot. Perhaps you remember that story. Mr. Rufus Choate spent no end of time examining expert witnesses and then summed up, and took one whole hour in demonstrating with tangents and co-tangents and all that sort of thing that there was a flat spot in the wheel. Mr. Daniel Webster got up — this happened in New York—and demolished the whole thing in about one half a minute. He said, "Gentlemen of the jury, there is the wheel. Go and look at it."

I think we feel a little bit the same way about poor England and ourselves.

MR. BLOUGH: I have no remarks to make, but just to set the record straight with reference to Dr. Lutz's remarks, the paper given this morning was my paper, and not Mr. Sullivan's paper. That was your great misfortune, because if the Assistant Secretary had been here, perhaps you might have had a more definite statement of policy than the rather indefinite one which you regret.

CHAIRMAN LELAND: Is there any further discussion?

J. W. OLIVER (New York): I would just like to ask Dr. Blough if they have in their studies advocated or are thinking of presenting a plan of forced savings. I know that a number of corporations are asking their employees to submit to a regular deduction from periodical payroll payments, and they use those to buy defense bonds, but that is not very successful.

I think we will all agree that the working man is getting the benefit of the greater bulk of the increased spending at the moment, and I was just wondering what the plans are, if any, about enforced savings, on the working man who is getting together part of the defense money that is being spent.

MR. BLOUGH: Mr. Chairman, at one minute to twelve, and we are supposed to be out at five minutes to twelve, or whenever it was—I don't believe—

CHAIRMAN LELAND: Oh, you have more time than that, Roy. I have four minutes.

MR. BLOUGH: I thought the Chairman was my friend!

CHAIRMAN LELAND: I am; but I never knew you to back down.

MR. BLOUGH: What time were we supposed to be out of here? I ask that in all seriousness, because I don't want to start this unless I can finish it, and it will take me some little time to finish it.

CHAIRMAN LELAND: I have got four minutes to twelve. I broke my watch before I came up here and I got this thing, but I think it keeps pretty fair time. It was all right yesterday. Four is right. You have got five minutes, Roy.

MR. BLOUGH: I had intended to say some of these things this afternoon, and may still do so. The recommendation which has been made, I think perhaps most effectively by Mr. Lutz, has not been an enforced savings plan, but has been a plan for a gross income tax.

If I misstate you, I hope you will correct me.

MR. LUTZ: Right.

MR. BLOUGH: At a rate of possibly 10 percent on American income receipts, to be collected at the source wherever possible.

Without going into the administrative problem at all, which I assure you would be of very tremendous character, as I understand the policy of the Treasury Department, it is this: that with respect to the very low incomes, regardless of the fact that some of those incomes are larger than they were before, we do not wish to impose heavy tax burdens—heavier burdens than would be imposed by certain taxes which are now in operation, particularly the social security tax—we do not feel that that group of people should be called upon to dig into their very meager earnings, which have not been and are not capable of supporting a very successful standard of living, for a large support of the defense program through taxation proper.

That doesn't mean that the personal exemptions have not been lowered. They have. That doesn't mean that you may not have a much larger imposition of taxes on the relatively smaller incomes than has been true in the past. That is something for the future to determine.

As I understand the feelings of the Treasury Department, they are that with respect to the very low incomes, getting down to the $100 and $200 and $300 and $400 and $500 incomes, that we cannot go into those incomes with the same degree of equanimity as we can the larger incomes, because of the simple fact that there really isn't ability to pay in the real sense of the term.

What the future will hold with regard to the necessity for controlling inflation by taking funds from that level of incomes, is a matter being accorded very careful study. On the other hand, we also are according careful study to the probable situation at the close of the emergency. It may be that some contribution for the purposes of inflation control might be necessary from groups at this income level, and it may be that they should have an income supplementation at the end of the war.

There are a number of avenues through which that might be accomplished, and which are receiving study. The social security program, and its expansion, is a possible avenue. The matter of dismissal compensation, or severance wage, in which individual accounts would be accrued for individual workers, and made available upon dismissal at the end of the war, has been referred to with favor on one or two occasions by the Secretary of the Treasury. Out-and-out compulsory saving has not, as I understand it, been very favorably received.

The point I am trying to make is this: that there is quite a difference between flat gross tax on all income to be taken away and never returned, and an imposition tax, if you call it that—a contribution, call it what you please—which may be taken during a period when inflation control makes necessary some action of that kind, and returned at the end of the war, either through the regular social security program or otherwise, is quite a different matter, and is receiving careful study.

I should say, for the protection of the department and my own protection, I am only giving my own views of what I think is a matter of interest concerning the Treasury. I certainly would hate to have it come out that I am expressing what Treasury policy is. That is not for me to say.

CHAIRMAN LELAND: It is also a matter of record that he had his fingers crossed.

Now the time is up and the lunch will be in the Coffman Memorial Union Building, and we are hereby declared successfully adjourned, after a most delightful morning.

(The meeting thereupon adjourned, at twelve o'clock.)

EIGHTH SESSION

TUESDAY, OCTOBER 14, 9:40 A. M.

Murphy Hall Auditorium
University of Minnesota

ROUND TABLE CONFERENCE

Fred W. Nelson, presiding.

CHAIRMAN NELSON: Due to slight delays in transportation to the University we are now a few minutes behind our opening schedule.

I am informed that to arrive promptly at the 12:30 luncheon session in the Coffman Memorial Union, we should adjourn this meeting at 12 o'clock.

The subject of this round table discussion—"Problems of Local Tax Administration"—opens a broad field, and I can assure you we have some very informative papers to be heard. Because of the fullness of our program and definite time limitation I shall make my opening remarks brief.

The usual rule of ten minutes for presentation of papers we shall try to observe, and I would suggest that to assure each scheduled speaker time to be heard we waive the seven minutes discussion period until conclusion of all the papers.

We hope then to have some time for questions and discussion.

ADVANTAGES AND DISADVANTAGES OF THE COUNTY ASSESSOR SYSTEM

DIXWELL L. PIERCE
Secretary, California State Board of Equalization

"A nice dilemma we have here,
That calls for all our wit;
And at this stage, it don't appear
That we can settle it." [1]

These lines, written by Sir W. S. Gilbert sixty-six years ago, seem particularly appropriate today as applied to the situation confronting us in the assessment of property taxes throughout the United States. It will be recalled by those who attended the Na-

[1] From "Trial by Jury", Gilbert and Sullivan.

tional Tax Conference at San Francisco in 1939 that this is not the first occasion on which these words have been heard in such a meeting. There, "Trial by Jury" was presented,[2] and the whimsicalities of Gilbert and Sullivan served to divert the audience from the enigmas of taxation. That the same lines may be used here to direct attention to one of these enigmas demonstrates the genius of the incomparable pair who fathomed so skillfully the foibles of their fellow men.

If any system of tax administration could have been eliminated by frequent expression of adverse expert opinion, local assessment of property for tax purposes would have been discarded long ago.[3] The surprising vitality of the system despite the continued criticism suggests that the indictment may be too sweeping. Could it be true that, although the experts are right in what they say as to the shortcomings of local assessments, they are wrong in urging that the remedy is total elimination of the assessor who is directly accountable to those whose property he assesses?

COUNTIES VARY GREATLY IN TAXABLE WEALTH

Possibly the dilemma may be best illustrated by relating a conversation between three assessors at the Thirty-ninth Annual Conference of the State Association of County Assessors of California.[4] Meeting at Santa Barbara last month, with the members and staff of the State Board of Equalization, the assessors devoted their sessions to such topics as "Economic Studies in Appraisal Practices", "Assessment of Industrial Equipment" and "Development of Soil Classification Maps." Between sessions, "shop talk" ran something like this:

> "How many assessments did you make in Los Angeles County this year, John?"
>
> "More than a million six hundred thousand, Chris. How many did you have in Amador County?"
>
> "Just a few over three thousand, but at that, I was way ahead of Dave Wood, next door in Alpine County. He had only two hundred and twenty-five."
>
> "What! Why he hardly started before he finished. How much was his total assessment roll?"

[2] Produced by Sacramento Light Opera Guild at thirteenth session of Thirty-second Annual Conference on Taxation under auspices of the National Tax Association, see *Proceedings* (1939), page 642.

[3] See *Special Report No. 10*, New York State Tax Commission, on "The Assessment of Real Property in the United States" (1936), for a summary of expert opinion, at pages 329 *et seq.*

[4] This association was organized at San Francisco in 1902 and has functioned continuously since then. Its papers and proceedings are published by the California State Board of Equalization, Sacramento.

"Only a little more than five hundred thousand dollars. Of course, the State Board assessed the utility property there—mostly reservoirs and aqueducts. I think that brought the grand total for Alpine up around a million and a half."

With modesty characteristic of his constituency, the Los Angeles County Assessor commented:

"Some contrast! In my county the assesment of tangible property is just a little under two billion five hundred eighty-three million. My part of that is two billion three hundred twenty-four million, so what the State Board does there is relatively small."

Nettled a bit at the superiority of his colleague, the Amador County Assessor rejoined:

"Our tangible property is assessed for sixteen million six hundred and forty thousand. That may be small compared with Los Angeles, but it's more than the total in each of fourteen other counties out of the fifty-eight in the State."

"What's the argument, boys?" This interruption came from the Assessor of the City and County of San Francisco, who happened to be passing.

"Oh, nothing, Russ", explained the Amador assessor, "just a little crowing from John here. He's reminding me how far the Los Angeles city limits go."

"Well, I have it over both of you. In San Francisco there is just one taxing district, the City and County, so I don't have to bother with a lot of separate city or district rolls the way you do. My assessment wasn't so small this year either. There will be one hundred thirty thousand tax bills and the total value runs over eight hundred and twenty-six million dollars."

"That's a fair-sized job", conceded the Los Angeles County assessor, "and there is some advantage in your combined city and county government. But then I do a lot of city assessing too. Out of the forty-four cities in my county, I assess for thirty-nine, including Los Angeles where the value is more than half of the total for the entire county. In fact, my assessment for the City of Los Angeles runs about five hundred million more than yours of San Francisco."

COUNTIES AND CITIES DUPLICATE ASSESSMENTS

"You are talking in figures out of my class."

This interjection came from Chris Meiss, the Amador County assessor, who continued:

"There are only four cities in my county and less than an eighth of the taxable wealth is inside of city limits. Yet, each of the cities has a separate assessor and tax collector."

"How do you account for that, Chris?" queried the San Francisco assessor, Russell Wolden.

"Well, they are old mining towns, and while they don't have much population, the people like to do things their own way. Actually, the city assessors don't bother to make their own valuations but copy mine."

"The five cities in Los Angeles County that do their own assessing show a little more originality", observed county assessor John Quinn. "In Long Beach, which is the largest of the group, the assessments run about thirty per cent higher. In Pasadena, the next largest city, they are fifty per cent higher."

"I should think that would cause trouble, John", commented the San Francisco assessor. "Don't taxpayers complain about two different values on the same property?"

"Yes, they do to some extent. But the complaints go to the city assessors because their values are higher. They keep them that way to meet tax rate limits which would not allow for sufficient revenue if their assessments were as low as mine."

"Why don't you raise your values? You have such a fine county, the people ought to be pleased at higher values."

"Now, Russ, I know San Franciscans are jealous about the way Los Angeles has forged ahead, but don't let that make you think that I have any idea of assessing higher than the State level, even to oblige Long Beach and Pasadena. My principal concern is to iron out inequalities and to assess all property as nearly as possible on the same basis as prevails generally throughout the State."

NO REAL COUNTY ASSESSING SYSTEM

The conversation did not end there, but enough has been quoted to show that the county assessor "system" presents a dilemma which may indeed call for all our wit if we hope to settle it. Nor is California peculiar in its congeries of procedure pertaining to the assessment of property for local tax purposes. Conditions elsewhere are even more distracting so far as the assessors are concerned. To use the appellation "system" in referring to the circumstances under which county assessors must perform their exacting duties, brings to mind the way in which Henry Morse Stephens, revered professor of history at the University of California, invariably began a series of lectures on the Holy Roman Empire. He was careful to explain to the class that what was so called was neither holy, nor Roman, nor an empire.

There are more than three thousand counties in the United States.[5] California, which ranks second in area and fifth in population, has only 58 counties in contrast with 254 in Texas, which ranks first in area but sixth in population. Georgia, with approximately one-third of the area and less than half the population of California, is blessed with 159 counties. Kentucky, with still less area and population, has 120 counties. With greater area and population than either Georgia or Kentucky, Missouri manages its local government with 115 counties. Pennsylvania and Tennessee have almost the same area. With more than three times the population, Pennsylvania has 67 counties to Tennessee's 95. North Carolina, with a fifth more area than Pennsylvania and a little more than a third of the population, has an even 100 counties. The area of Kansas is slightly more than half that of California, its population is about one-fourth as great, but it has 105 counties. These incongruities could be multiplied many times in other comparisons. It suffices to say that there is certainly no system in the way in which the states of the union are divided into counties, and that the principal damage which might result from rearranging them and reducing their number would be to local pride.

LOCAL PRIDE IMPEDES IMPROVEMENT

That the conditions under which county assessors work could be improved materially if the assessing units were better planned and less numerous seems equally self-evident. It must be admitted, however, that the possibility of accomplishing such a reform on any substantial scale appears remote. Local pride centering around a county name and court house is something with which to conjure. That improved facilities for transportation and communication may have altered greatly the need for so many county seats is of little consequence when the issues are "What towns shall no longer be county seats and what persons shall no longer be county officials?"

Again, we might invoke the aid of Gilbert and Sullivan, who had Pooh-Bah sing:

> "But family pride
> Must be denied
> And set aside
> And mortified." [6]

The trouble is that Pooh-Bah was not to be taken seriously, and I am afraid that, no matter how much they might applaud in theory, county officials cannot be taken seriously about agreeing to re-

[5] For a list of the counties in the United States, see Rand and McNally, *World Atlas*, Premier Edition (1941) at page 150. See, also, *The Units of Government in the United States* (Public Administration Service, Chicago, Illinois, 1934) by William Anderson.

[6] From "The Mikado", Gilbert and Sullivan.

arrangement of counties more logically — if that rearrangement should mean the end of their jobs.

This is indeed a gloomy picture. Unfortunately, if painted in all its detail, it is even darker. While the county is the assessment unit in twenty-two states, in sixteen states the town or township is the unit; in other states there is a dual arrangement or mixture between county assessment and town or township assessment. Generally, southern and western states have adopted the county unit, while New England states, or states in which the New England tradition has dominated, have assessed on a town or township basis. Thus, there is no uniformity throughout the country as to the use of the county as the assessment unit, and there are many more primary assessment areas than the 3,070 counties or parishes.[7]

DUPLICATE ASSESSMENTS IMPAIR EFFICIENCY

Worse yet, is the duplication of assessment work to which allusion was made by the assessors in their "shop talk". In California, overlapping assessments are made in 279 cities and in 250 other districts. The total for the United States is the staggering figure of 6,330. These duplicate assessment areas exist in almost half of the states and are found in substantial number in at least fourteen of them.[8] If the time and effort spent on making duplicate valuations of the same property for tax purposes could be concentrated on one good assessment, a marked improvement in the work of local assessment could be achieved. This should not be an impossible goal. It is something more easily attained than the redistribution of primary assessment areas, either through elimination or consolidation of counties or townships or through creation of larger assessment districts utilizing lines of established political subdivisions. Desirable as these other reforms may be, it must be recognized that they will prove difficult of accomplishment.

STATE ASSESSMENT NOT THE BEST ALTERNATIVE

It is submitted, however, that these difficulties should not lead to the conclusion that central state assessment is the only practicable way out. After thoroughly reviewing the situation, Professor Harley L. Lutz, a former President of the National Tax Association, has declared:

[7] There is an excellent discussion of assessment areas in *Property Taxation in the United States* (University of Chicago Press, 1931), by Jens Peter Jensen. This will be found in a chapter on "The Local Assessment", beginning at page 331.

[8] See *Overlapping Assessment Districts*, Second Progress Report of the Committee on Assessment Organization and Personnel, National Association of Assessing Officers (1938).

> "The general conclusion which has been reached from this study has been that *state* control of *local* administration has been beneficial, and should be extended in some directions even further than at present, in order to permit the correction of certain defects still existing. Complete state assumption of the functions of local administration is, however, quite another matter and it is doubtful if this extension of state activities can be justified. For the sake of local self-government, and even of democracy itself, can the State afford to deprive the local unit of all responsibility in a field so important for the whole people as that of taxation."[9]

My answer is, "No." I realize that there is expert opinion in disagreement. For example, a monograph prepared for the state tax commission of New York concedes that there is a rational basis for the institution of local self-government, but asserts that there is no ground for urging this basis as an objection to state administration of the function of assessment. It is said that there is no loss to self-government arising from the transfer of this function, because the factor of policy determination is entirely absent.[10] From this view I must dissent vigorously.

ASSESSOR IS NECESSARILY POLICY MAKER

In the whole structure of local government, there is no other official entrusted with as much authority to act upon his independent judgment as is the assessor. True, he may not determine how much the total tax collections shall be nor how the taxes shall be spent. But upon the performance of his function depends the apportionment of the tax burden between the property owners. Of necessity, much must be left to the soundness of his judgment. To assert that the work of assessment is so purely administrative as to involve no policy determination is to ignore what must be obvious to anyone who has observed the actual operation of tax laws.

If the assessment of property for purposes of ad valorem taxation is to be transferred entirely from local to state administration, more than the transfer of a purely administrative function will be involved. It seems clear that Professor Lutz spoke advisedly when he referred to such a change as one whereby the state would deprive the local units of basic responsibility in that field of taxation whence comes their principal support. What, then, are the advantages of the county assessor system and how can its disadvantages be minimized?

9 *The State Tax Commission*, Harvard Economic Studies, Vol. XVII (1918).

10 *Special Report No. 10*, New York State Tax Commission, on "The Assessment of Real Property in the United States" (1936) at pages 324 *et seq.*

ADVANTAGES OF LOCAL ASSESSMENT SUMMARIZED

First, local government has the largest, and sometimes the only financial stake in property taxes. It is desirable that the responsibility for the administration of these taxes, particularly as to policy matters, should rest with the governmental unit dependent upon the proceeds.

Second, a local assessor is apt to have a more thorough knowledge of conditions affecting the value of property in his jurisdiction than is an assessor functioning under an authority operating on a state-wide basis, even though his assignment may take into consideration his familiarity with local conditions. It is desirable that an assessor should have as complete information as possible with respect to the factors affecting property values; technical knowledge concerning these is not to be discounted, but can be acquired with reasonable diligence, or, in the larger jurisdictions, can be had through the employment of expert assistants; practical knowledge derived from actual familiarity with local conditions is not something that can be acquired quickly and involves an element of policy-making indispensable to sound assessments.

Third, the convenience of taxpayers is apt to be served better by a local assessor than by a state agency because it would be the natural tendency of the central authority to limit the number of its offices and the authority of its representatives at the branch offices. It is desirable that a taxpayer should be afforded as full an opportunity as possible to talk to the assessor who is ultimately responsible for the valuation of his property and to consider with the assessor those factors affecting value that are essential policy matters; this need not involve exercise of personal or political influence if the assessor is given a reasonable chance to do a good job.

Fourth, large organizations, such as would be required if state assessment should be substituted wholly for local assessment, tend to become unwieldy and to move more slowly than small ones because of the difficulty of delegating responsibility to subordinates. It is desirable that the assessment of property be handled with all dispatch consistent with sound consideration of the factors affecting value; under modern conditions values change rapidly and if there is delay in arriving at conclusions, it will be impossible to make readjustments as quickly as fairness demands; moreover, the assessment procedure should afford the taxpayer an opportunity for prompt relief if his property has been valued erroneously; delayed justice is no justice at all.

Fifth, large organizations, such as would result from centralization of all assessment responsibility in the state, tend to become bureaucratic and less responsive to public needs than small ones, because of the impersonal character of large units of government in which it is impossible for those in charge to give personal attention

to any substantial part of the work. It is desirable that the assessment of property be handled in such a way as to give the taxpayer as much assurance as possible that the valuation of his property has not been arbitrary but has been determined by someone who is willing to listen to him and to explain to him the basis of the assessment in terms that he can understand; there is, unfortunately, an undeniable tendency of the personnel in large organizations, especially in government, to develop an attitude toward the public which is far from conducive to the sort of relationship described as desirable.[11]

This is by no means a complete summary of the advantages of the county assessor system but should suffice for the purposes of discussion. There are, of course, relative disadvantages. Within the limits of the time at my disposal, I shall endeavor to show that these may be met by procedures which should not impair the basic principles of local assessment.

DISADVANTAGES OF LOCAL ASSESSMENT SUMMARIZED

First, although the local government may be the major, or only, beneficiary, of the property tax, there are types of property, notably public utility holdings, which are not readily adaptable to local assessment because of their unitary character as systems which frequently extend into several counties. It is desirable to provide for central assessment of such holdings in order that the unit value may be recognized and also to prevent any tendency toward unfair apportionment of value arising out of intercounty rivalries which might result in inequitable treatment of the taxpayer; this need not, however, impinge upon the assessment locally of property not a part of systems of this kind.

Second, under modern conditions, there is much specialized property to be assessed in various taxing jurisdictions, as to which a local assessor without technical training may be at a serious disadvantage; examples are afforded in such holdings as petroleum fields, mines, and factories which are parts of large commercial enterprises. It is desirable to provide the assessor with the technical assistance of a state organization whose duty it shall be to advise assessors on these problems and to ascertain that each assessor is following the established principles of valuation procedure in arriving at his assessments; this need not involve unwarranted interference with the functions of the assessor or friction between him and the central agency which, under intelligent and sympathetic management, may become a service bureau for assessors.

[11] For an excellent discussion of the pros and cons of local assessment and state assessment see *The State as an Assessment District,* Third Progress Report of the Committee on Assessment Organization and Personnel, National Association of Assessing Officers, Chicago (1938).

Third, taxpayers occasionally endeavor to exert undue influence on a county assessor that would not be attempted with respect to a state organization because of the greater familiarity with the local assessor and of the relative ease of access to him. This can be controlled to a large extent by cooperation between the assessor and the state authorities who are in position to protect him by issuing rulings for his guidance to which he can refer in answer to the taxpayer and by sustaining him through correspondence or consultation in individual cases where that aid may be required. Such procedure need not involve paternalism on the part of the state nor lack of stamina on the part of the assessor; it is a matter of practical cooperation in meeting successfully the pressure which sometimes is exerted on the assessor locally to an extent inimical to his efficient functioning unless he can secure help from the state organization.

Fourth, the county assessor is usually not equipped to handle all of the technical problems confronting him under the complicated industrial and economic system which now prevails; his budget is too small to enable him to augment his facilities or his staff to meet such situations. In many instances, as has been pointed out, the counties are too small to be satisfactory units of government under present-day conditions; that is not so much the fault of the county assessor system as it is of the county system. Until local pride can be sufficiently mortified to provide more logical units of local government, the best that can be done is to emphasize the importance of the assessor's work and to see that his compensation is at least approximately commensurate with what is expected of him. Meanwhile, this effort should be supplemented by as much technical help as the State is in a position to afford, with due regard always for the fact that it is the assessor's responsibility to assess.

Fifth, the county assessor is sometimes so intimately acquainted with his constituents that there is a tendency to show preferment which would not be possible in a larger, more impersonal office. This can be mitigated to a large extent by thoroughgoing supervision of his work by a central agency which has full power to require him to conform to established standards in the performance of his work. A nice balance must be struck to avoid the substitution of the judgment of the central agency for that of the assessor, at the same time supervising him closely enough to see that he uses judgment and not favoritism in arriving at his values.[12]

ASSESSORS NOT AFFORDED FAIR CHANCE TO DO GOOD JOB

These are some rudimentary considerations affecting the work of the assessors. In a modern American state the problem of getting reasonably complete and adequate assessment rolls for ad valorem

[12] See note 11, *supra*.

taxes is by no means a simple one. The basic principles may be simple but the work is most complex. The demands upon the assessor are exacting and his responsibility is heavy. Yet, because of assessing units that are too small, or overlap, or of penury on the part of those responsible for the compensation of assessors and provision for support of their offices, many an assessor is woefully underpaid and is expected to work without enough equipment or help to do a decent job.[13] Under such circumstances, the fault lies, not with the assessor or his local selection, but with the provision for him and his office. The remedy will be found, not in the abandonment of the county assessor system, but in applying sound principles, through providing a decent compensation for the assessor, an adequate office adequately staffed, and a reasonable amount of guidance and assistance from a state agency which will so conduct its relations with him as to inspire his confidence and respect without apprehension of substitution of its will for his judgment.[14]

After reviewing the disabilities under which the local assessor has been compelled to function, one is drawn inescapably to the conclusion that much must be done to improve his lot before it can fairly be said that the county assessor has been afforded a system which gives him an opportunity to work with the degree of efficiency which we have a right to expect in these days when taxes take so large a part of our incomes.

Finally, to borrow once more from Gilbert and Sullivan,

> "In a contemplative fashion,
> And a tranquil frame of mind,
> Free from every kind of passion,
> Some solution let us find.
> Let us grasp the situation,
> Solve the complicated plot—
> Quiet, calm deliberation
> Disentangles every knot." [15]

[13] For a discussion of these conditions see *Selection, Tenure and Compensation of Assessors*, Ninth Progress Report of the Committee on Assessment Organization and Personnel, National Association of Assessing Officers, Chicago (1940).

[14] See "Meet the Assessor", by Dixwell L. Pierce, in *California, Magazine of the Pacific*, December, 1940, published by California State Chamber of Commerce, San Francisco. For constructive recommendations as to improvement of assessment organization and personnel see *Report of the Committee on Assessment Organization and Personnel*, National Tax Association of Assessing Officers, Chicago (1940).

[15] From "The Gondoliers", Gilbert and Sullivan.

DEVELOPMENT OF A MODERN CITY ATLAS

EDWARD S. GOULD
City Assessor, Minneapolis, Minnesota

The first atlas of the City of Minneapolis was in map form. Several such basic documentary maps and atlases, compiled and published between the years 1856 and 1888, have contributed to the completion of the new 1940 Atlas of the City of Minneapolis. A listing of the more important of these is given on a separate page. In each case the map acted as an atlas in so far that it contained the necessary platted legal descriptions of the property within the limits of the town or city. The first atlas of this area was a map approximately three feet by four feet, of St. Anthony City and Minneapolis, compiled by Chapman and Curtis, civil engineers and land agents and published in 1856. The map covered both sides of the river and showed lot numbers, block numbers and the names of plats and additions. Prior to this time the maps in use had been those compiled from early government surveys. The plat of the Town of St. Anthony and the plat of St. Anthony Falls and also St. Anthony City was compiled in 1849. In 1855 a plat of the Town of Minneapolis was filed. As the Town of Minneapolis and Town of St. Anthony grew, many maps were required from time to time, in all twelve important maps were published between 1856 and 1888. The first atlas of the State of Minnesota was the one published by A. T. Andreas in 1874. This book contained a map of the City of Minneapolis. Atlas maps continued in vogue through the Abbott and Chapman map of 1888. However, the necessity of an atlas in book form brought the atlas of Minneapolis by G. M. Hopkins in 1885. This was followed by the various publications of 1887, 1892, 1903 and 1914. The 1885 atlas is very interesting from many standpoints, one of which is the collection of maps contained in book form. They are evidently copies of existing plats which vary in scale from 200 feet to the inch to 500 feet to the inch, no attempt having been made to revise or redraw the maps to a standard scale.

The 1940 Atlas of the City of Minneapolis was sponsored by the City Assessor and compiled and drawn from official records by the Minnesota Work Projects Administration under the supervision of the sponsor.

There are a number of things to be considered in regard to building a modern atlas of a city. The time allotted for this discussion does not allow going into full detail. We will, however, take up the various steps and problems in such a way as to give a progressive picture of the work involved.

Our preliminary study disclosed various items of a more or less technical nature which required careful consideration. The size,

shape, material and construction of the finished book was one of our first problems. The book must be of such size and shape that it can be handled with the least amount of difficulty and the material and construction should be strong and durable within the limits of permissible weight. A great many materials and methods were studied and tested before a decision was made on the following specifications.

In order to determine the size of the page it was necessary to set up the scale of the maps and the area to be covered by each page. It is, of course, desirable to have as large an area as possible portrayed on each page, however, since the page must be of such a size as to be conveniently handled, and the scale large enough to make the subject matter readable, a balance between the two factors is necessary. We found that a scale of one inch equal to two hundred feet would be a convenient and readable scale and would provide for a map area one-half mile east and west by three-quarters of a mile north and south, being three-eighths of a square mile or section on a page having a dimension of fifteen and one-half by twenty-three inches. There are one hundred sixty-eight such pages of maps in the Minneapolis Atlas.

The maps are so arranged that when the book is opened the two pages have contiguous maps showing an area of three quarters of a section. Some books of this kind have the maps covering the double page without a break at the binding, thereby causing difficulty in reading through the vertical center line of the map. By allowing for a small binding margin we have eliminated this difficulty.

The maps are printed on both sides of an opaque sheet of tag cloth, which was a special run by the mill to insure uniform color, weight and opaque qualities. Most of the material, both paper and tag cloth, which we tested for this job was transparent to a degree which prohibited printing on both sides of the sheet. Printing on only one side of a thinner sheet would have made the atlas practically twice as thick as it is, which was one of the things we wished to get away from after having had experience with the bulky book containing the Minneapolis Atlas of 1914. In binding, the pages were gathered into sections which are double sewed on tapes. This method of sewing and binding provides a flat opening book, a desirable quality in an atlas. The double sewing adds strength which was increased to a maximum by backing the bound edges of the sheets with a good grade of leather. The bound pages are hung in the covers with this leather backing, the tapes to which the pages are sewed, and a wide facing of buckram. The covers are a heavy tar board which will stand a great deal of abuse; in fact, it is practically impossible to bend them in any manner. The outside covering or binding is a water-resisting buckram with very good wearing qualities. In testing these various materials, they were bound as proposed for the finished atlas and subjected to handling and wear approximating twenty years of average use.

The finished book is about an inch and three-quarters thick and weighs approximately twenty pounds.

The entire personnel used on this project, with the exception of a supervisor from our office, was taken from W.P.A. forces. Draftsmen and statistical clerks trained in atlas work were impossible to secure, therefore a considerable amount of time was spent in training the men for the various technical jobs which made up the project. The more experienced draftsmen naturally were able to proceed faster in the training program and consequently were used to assist and guide the remainder of the crew. Standards were set up for all phases of the work; for example, lot dimensions were placed in a standard position wherever possible and were of a certain size, and lot and block numbers were also governed by similar standards. Wherever possible, mechanical lettering equipment was used to insure uniformity, thereby allowing several draftsmen to work at this job without any variation in the finished product. The mechanical equipment was used for street names, the names of additions, block numbers and similar work where uniformity was necessary. The lettering of small figures was done freehand.

Training of statistical clerks, while not as difficult a problem as that of the draftsmen, required a good deal of supervision by some one familiar with the departments and records of the City Hall and Court House. Many questions were constantly coming up as to where this could be found and where that could be found. Wherever possible, copies of records, maps, or proceedings of the council and boards were secured and placed on file at the project location for handy reference. Where records could not be taken from this source, two or more clerks had to be trained to secure the desired information from the records and transmit it on a regular form to the draftsmen. All such forms were bound loose leaf in ring binders and kept for future reference or authority for the final data on the maps. Systems used by the various departments are, of necessity, highly specialized and a great many of the records making up these systems are constantly in use, therefore careful training of clerks was very important. The turnover in personnel was a serious problem which, coupled with the training problem, made rapid progress impossible.

The information required for the various details of the original drawings was taken from official records wherever possible. These details include the official names and dimensions of streets and alleys; the name, lot numbers, lot dimensions and block numbers of additions and subdivisions; the controlling address at each street intersection; the location and size of sanitary sewers and storm drains, water mains, and hydrants, the location of transportation facilities such as bus lines, street-car lines, and railroads, the shore lines of water areas and the U. S. Government harbor lines. The required information was collected by a research staff who set up

the layout from which the draftsmen worked. All details were carefully checked by the research clerks, as for example the dimensions of the various lots were taken directly from the record plat of each addition and subdivision as filed with the Register of Deeds. Copies of a base map which is used by the Assessor's Department were used as a record sheet. Any variation found was traced back to its authority, such as a resurvey or perhaps a court order, which was noted thereon. The corrected maps were placed on file and became the authoritative source of lot sizes, lot numbers and block numbers. All information concerning street names, widths, openings, and vacations were taken from official City Council proceedings. Information so secured was noted on a form provided for this purpose and was filed in a loose-leaf ring binder where it became an index of street data. In a similar manner the proceedings of the Board of Park Commissioners and the School Board were scrutinized for complete and official names of parks and schools and for any other details which would have a bearing on the information contained in the Atlas. We found the transportation companies very cooperative in furnishing information concerning bus, street railway, and railroad property. In each case they furnished us with maps and detailed information as required for a complete portrayal of the transportation system in the city. We were also able to secure the Federal Government Survey maps showing the harbor lines and shore line of the Mississippi River as platted from their survey notes. In this manner we were able to eliminate errors which had been carried down from one atlas to another in former publications.

We found plenty of material available from various department records but found that it was usually kept in a manner best suited to the use of that department. In our department we have a great many records pertinent to the appraisal of Minneapolis real estate. We found, however, that the best method for determining the location of the buildings on a parcel of ground was through the use of aerial photographs. These photographs are enlargements made from pictures taken from a plane at an altitude of approximately 8,400 feet.

For this phase of the work, which was done by the Mark Hurd Air Mapping Corporation, we prepared a set of specifications which together with the cooperation of the photographer gave us splendid results. This is the first time, to our knowledge, that an area of this size has been photographed to this degree of accuracy, namely, a permissible error of one percent which actually resulted in practically only one-half of one percent. One requirement in the specifications was an overlap of fifty percent in each adjoining picture. Exposures, therefore, had to be made each quarter mile which, even with a slowly flying plane, made intervals between shots of about six seconds. The camera used was a magazine type containing a roll of film of one hundred exposures, and was equipped with a lens

having a focal length of twenty inches. A crew of four men were required to do the photographing, which was done through a hole in the floor of the plane. In order to keep the lens parallel to the ground the camera was mounted in a support which allowed moving the camera to a level position indicated by level bubbles fixed to the housing of the camera.

Contact prints from the negative were delivered by the photographer to our staff, who in turn noted control distances between street intersections along the outside limits of the picture. These prints were then returned to the photographer who used the figures contained thereon in making the enlargement to the scale of one hundred feet to the inch. In making the enlargement, the negative is placed in the enlarging camera and the image projected upon a movable screen and enlarged to the correct scale for the dimensions or distances as given on the contact print.

This screen was rather an interesting affair. It was so constructed that it would revolve about both a vertical and horizontal axis and was mounted on a track in order to control the size of the image by moving the screen to a given distance from the enlarging camera. The idea of revolving the screen was to further correct the picture to a horizontal position thereby approximating a ground survey.

Building data was transferred from the enlargements of the aerial photographs to the working drawings through the media of block maps. The block maps which were portions one block in area taken from the City Assessor's Department base maps, after having received the outlines of the buildings in their position on the various parcels of ground were used as the basic source of all information in regard to building locations, shapes and addresses.

Working drawings at a two hundred foot scale required drafting ability not found in the average draftsman; therefore the original drawings and tracings were made at a scale of one inch equals one hundred feet and reduced to a two hundred foot scale when the tracings were photographed for making the printing plates.

The working drawings, one for each page in the atlas, were mounted on a three-sixteenth inch thick masonite board, which was squared up and counteracted to avoid warping, thereby providing a drawing board for each drawing.

The use of the ordinary wooden drawing board was out of the question because of its bulk. To provide a working surface on the masonite board, a base map was first mounted on the smooth surface of the board, then a sheet of tracing paper was mounted over the base map. Since both the drawing surface and the counteracting backing were glued firmly to the board with waterproof casein glue, shrinkage and expansion of the drawings due to change in atmospheric conditions were completely eliminated. The boards were filed vertically by map or page number in a cabinet designed and built

on the job for this purpose. Visible indexing on the cabinet made the selection of a desired map a simple matter. All detailed drawings and corrections were made on these working drawings, thereby providing for a minimum of handling of the final tracings.

Certain properties shown in the Atlas were designated or identified by their official names or a characteristic symbol directly on the final tracing. Schools were given their official names, and churches designated as such. Railroad property used in the operating system of the road was bounded with a broken line to make it stand out from the general picture. Park property was stippled with a ball point pen and India ink, the dots being shaded in intensity from the border to the center of each park area. Using this system directly on the tracing cloth eliminated the necessity of any designation on the printed pages of the Atlas.

The final tracings on cloth were made from the working drawings. Here again we were faced with expansion and contraction of the tracing cloth due to atmospheric conditions. To eliminate this difficulty we used tracing frames into which the masonite drawing boards were fastened after the original drawing had been checked and was ready for tracing. The tracing cloth, while slightly damp, was stretched over the working drawing and glued to the edges of the frame with casein glue which would set before the tracing cloth would dry and shrink. After drying and shrinking, the cloth remained tightly stretched throughout the tracing period. When finished, the final tracing was cleaned, cut from the frame and packed for shipment to the printer.

In the process of photographing the tracings, the printer reduced the maps to a two hundred foot scale.

This type of work is highly specialized, requiring extreme accuracy to insure a uniform and correct scale reduction, and to secure a clear, clean-cut negative in which the various weights of lines will show up as they do on the original. Fortunately the photographer was able to set up his equipment and run a number of plates through at one setting. Negatives of two adjoining plates were lined up and fastened together by the photographer preparatory to making the zinc plate for printing the double pages.

In printing the maps, which was done by the offset method, a number of paper copies were run and approved before the tag cloth sheets were placed in the press. It was necessary to provide an over-run for possible spoilage and for various uses, such as the master sheets in the coloring process.

After printing, the maps were sent back to the drafting department for color outlining the boundaries of the additions and subdivisions. By using a characteristic color, the boundary of each addition and subdivision was made to stand out from the remainder of the page and thereby make the map more readable. Color printing was considered and rejected because of the expense involved,

other methods failed because of fading, difficulty in application, or some similar reason. In the final analysis, the outlines were made with a non-fading dye thinned with turpentine, applied with a narrow felt strip held between the points of a draftsman's ruling pen. A series of master sheets, one for each color used, were prepared for each map, one man tinting all the outlines of one color on a page, thus providing a production line method for completely coloring a page in one run through the line. This method minimized handling the maps which were given a final check at the end of the line.

The purpose of this project has been twofold. One purpose, to provide employment and training for men on the lists of the Work Projects Administration, has been successfully carried out, as demonstrated by the number of men who left the project for private employment. The other purpose was to provide the City of Minneapolis with a modern up-to-date atlas of the community. The second purpose was carried out by careful research of the official records of the city and the collection of these data into a sturdily-bound volume upon which the future expansion and changes in the community can be based.

BASIC DOCUMENTARY MAPS AND ATLASES CONTRIBUTING TO THE 1940 ATLAS OF THE CITY OF MINNEAPOLIS

Maps of the U. S. Govt. Survey 1847 to 1885
Maps of the City of St. Anthony & Minneapolis (Chapman & Curtis, C.E.) 1856
Map of Minneapolis and St. Anthony Falls (land map) (Talcott) 1857
Map of St. Anthony & Minneapolis (R. & F. Cook) 1861
Map of Minneapolis (Franklin Cook) 1872
Map of Minneapolis on Hennepin County Map (Geo. B. Wright) 1873
Map of Minneapolis in Atlas of State of Minnesota (A. T. Andreas) 1874
Map of Minneapolis (George B. Wright) 1874
Map of Minneapolis (E. T. Abbott) 1883
Map of Minneapolis (E. T. Abbott) 1884
Atlas of City of Minneapolis (G. M. Hopkins) 1885
Atlas of City of Minneapolis (Abbott & Chapman) 1887
Map of City of Minneapolis (Abbott & Chapman) 1888
Atlas of City of Minneapolis (C. M. Foote & Co.) 1892
Atlas of City of Minneapolis (James E. Egan) 1903
Atlas of City of Minneapolis (H. W. Bennecke) 1914
Atlas of the territory annexed from Village of Richfield 1927
Aerial map of Minneapolis (Mark Hurd Air Mapping Corp.) 1938-39
Atlas of City of Minneapolis 1940.

TAX DELINQUENCY PROBLEMS

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INTRODUCTION

This presentation is based upon the experience in Chicago and Cook County, Illinois. Applications to other areas of the local diagnosis and recommended treatments, it is hoped, will be of value to other places. It appears that many of the common concerns about tax delinquency are found in this area, in an aggravated degree.

The presentation is attempted not merely to list the problems as such, but with their implications for constructive treatment.

Comment is earnestly invited to the end that our local efforts at solution may be more speedily and effectively accomplished.

GENERAL FACTS

Our tax delinquency is related to real property and personal property, and only to a small extent, the railroad classification. The latter, therefore, is ignored in this paper.

The size of our local problem is indicated by the following analysis of the facts as reported by the county treasurer on the last reporting date, September 15, 1941. A total accrued real estate tax delinquency of $144,000,000.

A total accrued personal property tax delinquency of $272,000,000.

An aggregate delinquency (including railroad) of $420,000,000 or 15% of the aggregate tax extensions on real estate, railroad and personal property, for the last thirteen tax years.

Only 80% of these aggregate extensions for real and personal property during this period have been realized in cash collections. On an average annual basis, $40,000,000 a year has escaped from the tax rolls as extended. About one-quarter or $10,000,000 a year escapes via court action on tax rate and assessment objections and about three-fourths or $30,000,000 a year awaits either collection or court action.

Thus, during the last thirteen years, a total in excess of $525,000,000 has, in effect, evaporated from the combined assessment base on real estate and personal property.

In considering the real estate and personal property delinquency facts separately, the following is recorded: less than 90% of the tax on real estate has been paid in cash.

Less than 56% of the tax extensions on personal property have been paid in cash.

Each year, the following routine in public revenue administration operates:

a. A demand is made upon the real estate and personal property assets as appraised by the assessor and as reviewed by the board of appeals, in an amount approximating $200,000,000. The normal assumption is that this demand is the product of a uniform and equitable assessment and will be responded to by a uniform collection. The great majority of the dollars and persons involved apparently react in reliance upon these two assumptions. This reliance, however, is only 80% good as above indicated. Nevertheless, each year an elaborate set of administrative activities are gone through with, with respect to several hundred thousand items covering assessing, reviewing, extending, billing, an office for receiving, and an office for enforcing. With respect to such a large volume of accounts, these operations estimated to cost in the neighborhood of $10 per unit, or a total in excess of $2,000,000, have been futile for years past, are now futile, and will continue so to be until the revenue policies and administrative actions are changed. At least the word "futile" has been and is currently justified, so far as producing revenue from these sources, let alone meeting the cost of putting them on the books.

b. The public finance officials of the 300-odd governments in our Cook County area are seriously handicapped with respect to any kind of sound financial planning. They are compelled to resort to devious methods to manufacture a balanced budget.

c. Tax warrant interest, high purchasing costs, floating debt, and similar items following in the train of this condition and thus adding materially and indirectly to the burdens imposed by the 20% escape from the assessment rolls, is another part of the routine.

d. It is thus competently estimated that the total direct and indirect burden placed upon the consistent and regular taxpayer approximates 25% of his tax bill, through the pyramiding upon the taxpayers of the delinquencies of the non-taxpayers.

e. The effects upon the private economy of the community of this condition are inescapable. Titles tend to become more tightly frozen year by year; liquidity in real estate, one of the basic financial supports of both public and private economy, becomes difficult. The new home development now current jumps over areas already fully serviced with transportation and local public and private utilities and occupies raw land farther out with individual wells, septic tanks, and little, if any, other facilities.

There is thus an economic loss in the failure to utilize existing capital wealth in the form of public and private utilities, conveniences and services, in addition to the hundreds of thousands of vacant lots within areas thus serviced.

f. In addition, there is the compounding of the urges for further decentralization plus the development of those collective discouragements which we call blight which settle upon areas partly utilized,

partly abandoned, and unable to justify financially as well as socially, the vain promises of premature subdivision in prior years. Labor, capital, in the form of building, re-building, and the many lines of commerce which rest upon an orderly real estate market are inhibited.

In summary, it may be a nice question as to whether the serious effects of such a condition are greater upon our community and others like it with respect to first, the hardship upon public finance administration or second, the hardship upon the general well-being of that community in its private aspects.

It was this latter group of concerns that aroused the attention of a large number of taxpayers in Chicago and Cook County when they realized the effect of a 25% pyramiding upon their normal, equal, tax share, and the collective harmful effect upon the social and business welfare of a community thus paralyzed.

Within the last two years, the commercial, legal, real estate, civic, farm and community forces have become awakened to this abnormal, unhealthy and unnatural condition. It appears, therefore, that the building up of interest, of understanding of the problems involved, and of the lines of treatment, are focusing attention toward solution.

THE PROBLEM IN ITS GENERAL ASPECTS

Historically, up until about 1930, the revenue administration of the area, so far as collections and non-collections were concerned, did not arouse much attention. Shortly prior thereto, the community had become exercised over a very evident inequality in real estate assessments. Accordingly, a modern, so-called scientific measurement plan for assessing real property was developed which is generally regarded as vastly superior to the hit-or-miss plan for which it was substituted. A few years later, a similar effort to develop equality in personal property assessments was developed under rules of administration laid down by the county assessor, after the old multiple board of assessors had been removed by statute. These rules were designed to invite cooperation from taxpayers in filing schedules, which would result in an effective tax generally comparable to what would be the burden under a formal classification statute or a formal income tax statute. The necessity of resorting to such administrative rules was imposed because of the existence of a constitutional requirement that all property, real and personal, should be valued alike.

It is, of course, known that any plan to secure as nearly as possible a 100% response in collections must be based upon a sound and equitable assessment. The proponents of assessment improvement in our area in their innocence or ignorance, or both, relied apparently upon the fact that with an improved assessment formula for both real and personal property, the general overall problem of general revenue administration would be solved. However, the tra-

ditions of looseness in both real and personal property assessments in prior years had bred such looseness in the collection policies and administration that improved action in the collection field did not follow the improved action in the assessment fields referred to.

Accordingly, attention is now being given to what, after all, is a very natural and logical relationship between assessments and collections. This is being attempted through diagnosing the problems which exist and in finding the policies — administrative, political, legislative — with resulting actions in pursuance of such policies which will bring that result to pass. Naturally, the improvement in assessment administration on real estate was followed by improvement in collection results because of the character of the subject matter assessed. The same correspondence has not resulted with respect to personal property as a subject matter. Refinements made year after year in the assessment standards and rules with respect to personal property have not been accompanied by similar applications in the collection divisions of the local government. The hang-over of the previous "catch-as-catch-can", or "pass-the-hat" basis of personal property administration, persists to some extent in some sections of the public and of the public administration services themselves.

In its broadest aspects, the problem requires, to some degree, the re-education of the politicians and of the administrators and of the public. This requires a new attitude to the effect that the public community has a right to expect of its public officials ordinary business-like integrity, in realizing cash upon the public bills receivable due the community, and to establish positive, responsible and accountable methods to that end.

Obviously, the largest single mainspring for such a re-education is a political policy of leadership followed by administration which will sympathetically but firmly do the work necessary to that end. It does not require any education on principle or theory or morals to justify an interrelation between the local government and its citizens or properties, that the latter should pay and should be made to pay their just dues to maintain the public services in a scheme based upon local democratic self-government.

At the bottom of the problem is the inertia of public officials, the lack of modern responsible organization in revenue administration, and in some quarters, the political fear of some officials that to exert their maximum powers in this direction would incur ill-will against them on election day from the pursued delinquents. In addition, of course, there is some slight modicum in our area, as there may be elsewhere, of the low-grade skullduggery known as the "political fix" which in effect is the lowest form of treason and cheating. This modicum of evasion in our area as in other areas, however, need not prevail under a revenue administration which adopted straight-line business methods in its performance.

SPECIFIC PROBLEMS IN GENERAL

Tax delinquency should be considered as a part of what it really is: revenue administration. The end result of the letter is to spread the costs of government according to some agreed policy and plan that will provide equality and uniformity in treatment which are the oldest equities in the law books and in the code of democratic morality; and then to see to it that that spread is responded to uniformly by the community so assessed.

Within this principle, the rest of the job is a collection of business operating details to secure the accomplishment of the indicated purpose.

Without attempting to break the problem down into its phases of accrued delinquency and current delinquency and the possibilities of future delinquency, these are the general items requiring attention in such field of detail:

1. There should be adequate records which, in effect, show who owes what or what owes what sum. In most of the modern public finance plants these records are being developed on land-lot ledgers which accumulate the tax bill per annum on one record rather than having them scattered as we formerly did, in annual warrant books too numerous to mention.

The same principle is to be applied to the personal property accounts per individual per year.

The same principle is being applied to the special assessment delinquencies per parcel.

Obviously, to the extent that such records of the amounts due the community for various kinds of service are assembled and handled through a common office, the better accounting and responsibility for results would be developed.

2. The information thus made collectively available is of value to the citizen in seeing what he owes or what it is claimed he owes the government in his public relations just as similar accounting is of value to him in his purchasing of other things than public service, in his dealings with his grocer or department store. It is known in our area that a considerable number of people are delinquent in fact, but they are unaware of that fact in the absence of making a real estate transaction, because each year their bill has been for the current tax only and no carrying-forward of delinquencies for their information and for the information of the collecting wing of the government is provided at regular intervals. Thus, the delinquency tends to sleep quietly until some concern external to the government's need for funds brings the issue up for attention.

3. The basic assessment plan in both policy and administration should be worked out with the utmost accuracy and adequacy since it is now known that considerable delinquency is rooted in insufficiency and inefficiency in the assessment beginnings. The use of

measurement standards now generally recognized in relation to real estate assessments and where personal property is still taxed, the use in effect of appropriate classification standards to produce a livable and uniform resulting tax, are likewise recommended.

4. The process of extending and billing are now reduced by machine processes to a comparatively simple and standard operation.

5. The receipt of taxes by the county treasurer should be followed by prompt accounting and distribution to the governments for which he is the agent to collect. His accounting statements to each of his client governments should record, for their information, their delinquency stake in each of the tax years of the past. In our area, most if not all of the governments except the major ones who keep a separate accounting for themselves, do not realize the tremendous sums due them in their share in our huge and abnormal total delinquency. Some of these delinquency stakes per government approximate a year's tax extension. Our total estimated collectible delinquency, accrued to date for the last 13 years, is equal to one year's tax extension on the real and personal property assets of Cook County. Such information, presented to the home folks, struggling with the local problems of school finance, village finance, park finance, and the like, would tend to stimulate interest in and action upon the collection difficulties.

6. Shortly after the delinquency date for the second installment for the payment of real estate taxes (there being only one installment date for the payment of personal property taxes) delinquency taxes on real estate are advertised and tax sales are had.

At this point the major difficulties in the inadequate revenue administration begin to appear.

There has been little, if any, positive or aggressive collecting effort in a collection agency sense, attempted by the county collectors for many years. Recently, an experimental effort was made by the present county collector with a result showing that merely asking delinquents politely but firmly could be highly productive, if adopted on a county-wide basis, under a regular administrative policy.

The traditional policy of collecting taxes has been largely that of receiving what has been offered. Records, system personnel, management and political policy, has all been keyed up to that standard. To many people that standard appeared to be good enough in our area, at least prior to about 1930. With the abrupt change in public and private financial affairs beginning thereafter, there has been substantially no change in the policies or methods hitherto used, although most every other business and financial administration has been compelled to make some adjustment in view of the change in scene.

As a result, there are powers available for collecting activity which have not been used for years. There is largely nothing done by the collective departments concerned to bring delinquent accounts up for constructive and aggressive attention. A delinquent person

or property may continue in that condition in our area, and blissfully receive the benefits of an expensive public service administration with respect to himself and his property interests and be practically undisturbed. In recent months there has been some animation to a very slight degree, through the service by the collector of his warrant upon current personal property delinquency and by the sheriff in threatening to levy upon personal property judgments and by the bailiff of the municipal court. These are all of them in the right direction, but they need to be, and could be, amplified and extended manyfold, and must be if they are to be significantly productive.

The state's attorney of Cook County is the chief enforcement officer, as well as the attorney for each of the several departments engaged in sections of the revenue administration, such as the assessor, the board of appeals, county clerk, county board, county treasurer, and appears on behalf of these groups in the courts, federal, superior, county, circuit and justice of the peace. During the last two years, he has undertaken a policy of forfeiture foreclosure actions by agreement with the delinquency interests, involving an agreed bid at the public sale. This has effectively cleared many properties involving in excess of $17,000,000 of principal of claims and producing a 70% to 75% of such principal in cash receipts. This activity, however, as good as it is, is not good enough by itself alone. The facilities of his office, if expanded, could handle far more cases far more rapidly.

One of the major problems lies in the area of enforcement organization among the county treasurer, the state's attorney and the courts above referred to. It is reliably reported by competent authority that in no other county in the entire country is there such extensive interference by the courts with the normal administrative processes of assessment and review of assessment. There is lack of agreement among litigants, officials, administrators and the courts, as to where the lines of jurisdiction between administration and court review thereof properly lie. To a considerable degree, it appears that court procedures are used in our county in a manner which in effect tends to negative the work of the assessor and of the board of appeals, particularly with respect to personal property assessments. Until then, the integrity and the authority of the primary assessment is both believed in and supported by the community, and the courts give protection to unsound assessments and to improper tax rating only under established procedures and statutes and decisions, this recognized and abnormal distortion between the administration and the courts is bound to contribute to the continuance of our delinquency situation. A condition which wipes out, through court adjudication on tax rate and tax assessments, for some people, an aggregate amount equal to 5% of the total tax extension on real and personal property, is perhaps unmatched in any

area. It is indeed a sad commentary upon the status of both administration policies and performance and of the relation between the administrators, the public and the courts.

7. Another problem lies in the field of failing to use existing powers and in the absence of some powers which ought to be made available in aid of more effective and adequate administration.

Any constructive attack upon the delinquency condition in any community would necessarily divide the issue between accrued delinquency and the possibilities of a continuing delinquency in the future and also, in each of these two categories, the treatment of different kinds of property delinquency such as real, personal, railroad, and any others because of different remedies and procedures available.

Other speakers will comment in detail upon the general question of procedures and powers. As a problem, however, in our area, the failure to use a quick and cheap method of bringing delinquent properties up for tax sale through what we call the three-officer certificate plan, is indeed striking. For over 60 years we have had a statute, which antedates the statutes governing special assessments, which provides that whenever the county judge and the county treasurer and the county clerk shall certify to the fact, if it exists, that the property in question is worth less than the liens outstanding against it, it is then eligible for a tax sale. Efforts are now being made to provoke the use of this procedure, which would appear to be eligible in scores of thousands of low-grade lots at least, where the more elaborate, expensive and time-consuming forfeiture foreclosure plan is not available.

The use of the three-officer certificate plan and of the forfeiture foreclosure plan, together with a positive collecting effort by the county collector, would go a long way to dealing with the accrued delinquency condition. The forfeiture foreclosure plan needs to be expanded to cover cases selected according to their availability even where those in the title may not be cooperating. In such cases, the county should become the bidding agent and recondition and resell, if it acquires title where it might in some small number of such cases, or where the title so acquired might be reassigned to some appropriate municipal agency for a public purpose such as schools, parks, forest preserves, and so on. Many communities are indulging in such a land-acquisition program for a public purpose where they have demonstrated there is no longer any private interest in the property or where it appears that the property has been virtually abandoned. There is obviously no sense to allowing properties to "cure" out under the sun without making any contribution to the support of the public services but rather the reverse, in contributing not only to their own further delinquency but to the delinquency and blight of the neighborhood in which they happen to be located.

Policies looking in this direction have been developed with apparent success in Michigan and in California. Every effort apparently is made to incite the interest of those in the title, whether as equity owner, mortgages, special assessment bondholders, or otherwise. Priorities and preference are given to such persons.

Such programs are to be commended. We are urging them in Illinois. We are cautioning our public officials, however, on two points:

a. That the liquidation or compromising features should be related first, to securing for the county the maximum of recovery and next that such recovery in each case should, as near as may be, be the same percentage of the present value of the properties compromised.

b. That in such compromise programs there be allowed to exist no incentive or inducement for property owners to secure such a benefit and then run another course of delinquency in order to develop a similar compromise benefit for themselves in the future.

The other phase of the delinquency control effort relates to reducing the tendency toward continuing delinquency in the future. Different policies and practices prevail in different areas. In general, the sound policy would seem to be to cash the delinquency when it occurs, while it is still young, and before it grows into a chronic case. In our state, we have a procedure which is called a tax sale which produces a tax deed which is merely a cloud upon the title. As a result, purchasers of such tax deeds are few and far between. Accordingly, the ancient enforcement collection policy of the state which set up the tax deed procedure is not effectuated. The recommendation here is that a simple adjustment be made in the statutes which will, in the course of four or five years, assure to the purchaser at a tax sale, that he will either have reimbursement of his advances of taxes on behalf of the equity owner, or he will have good title to the property purchased.

There are a considerable number of minor problems that might be listed. They all stem off of the major ones catalogued above. A general root cause of difficulty is the highly scattered administrative service of total revenue administration among six or more separately elected, staffed and financed agencies in our collective County of Cook organization. While it is true that the County of Cook, through the board of Cook County commissioners, is called the "fiscal agent" of the county and appropriates funds for the maintenance of these separate divisions, its responsibility and authority and support in the problem is almost a legal fiction. Its capacity to do anything about it is further negatived by the fact that each year for many years in the past, it has had to rely for about one-third of its total income upon the penalties received in tax delinquency payments. This amounts to approximately $7,000,000 per

annum. Thus, in effect, the chief fiscal agency, so called, has almost a vested interest in the continuing delinquency itself as a means of financing one-third of its own livelihood.

Finally, in searching for the mainspring for improving the conduct of an unsatisfactory and indefensible revenue service in our county, attention has now been directed to the spot which can do something about it, in a fairly quick and summary manner. Instead of dealing alone with the mirage of public opinion, instead of tinkering alone with statutory adjustments, instead of attempting statistical checks, and test area projects alone, instead of encouraging this office and then that office, to consider one or another item in the total progress, instead of merely measuring results from time to time and reporting the comparative status of futility and inadequacy, recourse is now being considered to the primary political and administrative authority of the community. The mayor of the City of Chicago, with respect to the city, the school board, the park district, and sundry other minor jurisdictions, has an official financial stake in approximately 75% or more of the tax income. While the revenue administration is not under his official jurisdiction, he certainly has an official interest in seeing that the revenue administration does produce what his official needs require. The president of the county board is the chief officer of the so-called fiscal agency which, in itself, with the related, separately elected departments above referred to, run the revenue show, is also clearly indicated as at the center of administrative and political responsibility and authority. The state's attorney of Cook County, while from some standpoints is a servicing officer in dealing with the legal problems of his public clients, does, nevertheless, retain independent power and authority to deal with a condition which is so clearly a monumental constructive misfeasance or nonfeasance or both, with respect to a very important aspect of local government, namely, its financial support.

There is every reason to believe that the latter will meet the tests of any new policy and administration that the two primary officials, the mayor and the president of the county board, may indicate as the new order of the day.

Such an order clearly uttered and forcefully supported up and down the line of administrative and political service, and implemented by an active central clearing house of management among the departments concerned with proper jurisdictional boundaries set up between administrators and the courts, and with adequate measurements of results obtained under such a policy and program, it may be confidently asserted that the issue of tax delinquency present, past and future in Cook County would be on its way toward a solution.

DEVICES TO FACILITATE PROPERTY TAX COLLECTIONS

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The ultimate objective in the administration of the general property tax is obviously the collection of taxes. Despite the importance of this final step, the collection process, including the enforcement of tax liens and the administration of tax-reverted lands, has undoubtedly been the most neglected aspect of property-tax administration. The nature of the collection process was aptly characterized by Mr. George O. Fairweather of the Special Committee on Tax Delinquency, Chicago, when he stated that "Historically, we have been working under a policy of receiving tax payments and not of collecting them." [1] The traditional attitude towards the collection of property taxes has been lethargic and passive rather than active and vigorous. The efficient collection methods employed by well-managed private business concerns have not been utilized to any significant extent by governmental units.

One of the most important reasons for the apathetic attitude of citizens and public officials to the problem of tax collection and delinquency is the fact that uncollected taxes did not constitute a significant proportion of total levies in most states prior to 1930. No great interest in the improvement of tax collection procedure developed when the volume of delinquency increased markedly during the 30's, because the belief was widely held that the improvement of business conditions would restore tax payments to their normal basis. For these reasons, a large majority of both citizens and legislators seem not to be cognizant of the fact that there is a problem of tax delinquency. Another important reason for the lack of interest in the reform of tax-collection procedure is the formidable opposition on many fronts to the disturbance of property rights through the enforcement of tax liens. The courts have leaned over backwards in protecting property rights against the enforcement of tax liens; legislatures have been reluctant to adopt vigorous tax-collection measures; and elective local officials have been hesitant to use the measures at their disposal to collect taxes for fear that harsh treatment might contribute to their defeat at the next election.

Before discussing specific devices for facilitating property tax collections, it seems desirable to comment briefly upon the two general factors that have been largely responsible for the delay in

[1] "Delinquency, Tax Sales, and Related Problems in Metropolitan Chicago," *Illinois Tax Problems*, 1940, p. 208.

improving tax collection methods. Although it is true that the percentage of uncollected taxes to total levies was not large in most states prior to the depression, it is nevertheless a fact that chronic tax delinquency is not exclusively a product of depression influences. Following in the wake of the western advance of the timber harvest was a wave of chronic tax delinquency. Large areas of cut-over land in the Adirondack and Catskill Mountain regions of New York were bid in by the state for non-payment of taxes before 1885.[2] The northern cut-over sections of Michigan, Minnesota, and Wisconsin have a tax-delinquency record similar to that of the mountain regions in New York. The Forest Taxation Inquiry disclosed that "The removal of timber values from many counties in northcentral Michigan and the subsequent failure of agricultural colonization precipitated a serious delinquency problem in that State as early as 1880-90."[3] Unredeemed lands returned to the State of Michigan in great quantities after 1896, the tax-reverted area amounting to 1,600,000 acres in 1930. Moreover, a similar trend towards chronic tax delinquency and reversion was evident in the timber country of the Pacific Northwest before 1930. The arid and semi-arid regions of the West and Northwest have also experienced serious tax delinquency. Montana had 4,600,000 acres of tax-delinquent land as early as 1931, and in 1933 taxes were delinquent on thousands of abandoned homesteads in western Colorado. Among other states in which land-use maladjustments took their toll in heavy tax delinquency in the pre-depression era were Arkansas, Florida, Louisiana, North Carolina, Mississippi, Virginia, and Texas. The decline of business activity after 1930 greatly increased the volume of tax delinquency, but the facts here presented indicate that chronic delinquency in many areas antedated the depression. Comprehensive statistics of recent date regarding the exact area and location of rural and urban lands with long-standing delinquency are not available, but scattered sources of information suggest that, despite the marked improvement in tax collections since 1936, millions of tracts are still in the chronically-delinquent class. From the standpoint of the entire area of a state, chronic tax delinquency is spotted in character, although it tends to be concentrated in certain districts. The areas of concentration in urban places are in the premature subdivisions that have been over-developed by unsound real estate promotional activities and in the blighted areas often found on the periphery of central business districts. The rural areas which have the largest volume of tax delinquency are the cut-over and soil-depleted lands and regions exhausted of coal and other mineral

[2] *Forest Taxation in the United States*, Forest Taxation Inquiry, Forest Service, Washington, D. C., 1935, pp. 80-81.

[3] *Ibid.*

resources. Since basic maladjustments in land use are responsible for the bulk of chronic delinquency, improved business conditions alone will not completely solve the problem. A few states have attempted to remedy the problem of chronic delinquency, but progress to date has been slow; and the problem of short-term delinquency has gone almost unnoticed.

Reference has been made to the over-cautious attitude of the courts and of legislators in protecting property rights from the enforcement of tax liens. It is true that the institution of private property is an essential feature of our form of government and must be afforded every reasonable protection, but after a certain point is reached, the rights of the individual must yield to the broader interests of government. The payment of taxes is an important obligation that attaches to the ownership of property. If the taxes remain unpaid after the owner has been given a reasonable opportunity to discharge this obligation to government, prompt action should be taken to enforce collection through the sale of the taxed property. Until this principle comes to be much more widely accepted than it has been heretofore, efforts to improve tax-collection procedures cannot achieve the success that is desirable.

In the following discussion of specific devices to facilitate property-tax collections, it is assumed that the burden of taxes upon property is not excessive; that all property is assessed accurately and uniformly; and that the various functions pertaining to the making of assessments, the extension of taxes, the collection of taxes, and the enforcement of tax liens are consolidated for all units and centralized in a single office. It is also desirable that all officers charged with the administration of property taxes be appointed on a merit basis, and that assessments be supervised by the state tax commission or other appropriate agencies. The interval between the effective assessment date and the collection of taxes should be reduced to a minimum, and the latter should be properly synchronized with budgets, tax levies, and the fiscal year.

Land-use maladjustments, it has been noted, are an important factor in chronic tax delinquency. Thousands of families are striving unsuccessfully to make a living on lands no longer capable of producing the bare essentials of life or of contributing a reasonable share of the costs of public services. Injudicious land use, however, is not confined to rural lands. An extreme example of improper land use in an urban community is described by Professor Louis Wirth as follows:

> "We have for instance the Chicago suburb of Skokie, formerly known as Niles Center, a place, which if it actually had been inhabited by as many people as the real estate promoters thought it ought to have been inhabited by, would have absorbed the

> whole population of Chicago and would have enough land zoned for business to accommodate the entire business of the United States." [4]

Prematurely subdivided lands in many cities are sufficient to supply a lot for a large percentage of the families living in the communities. Delinquent taxes against the vacant lots often exceed the value of the lots. The involved procedures and high costs of foreclosure render it difficult for municipalities to get a clear title to the lots. Because of the poor titles individuals refuse to build on these tracts. Private construction is thus often diverted to areas less accessible to the business district. Utilities and other public improvements already available in the distressed areas are often abandoned and duplicated in the new areas.

Positive measures should be adopted to prevent and correct rural and urban land-use maladjustments. Wisconsin has taken the lead in the adoption of county zoning ordinances to correct the misuse of rural lands. The zoning ordinances of cities should be strengthened, and the opening of new subdivisions should be more closely regulated. These measures should be supplemented by a stricter control of real estate promotional activities and by better city planning.

Accurate and complete tax maps and tract-ownership records are essential implements in the efficient collection of property taxes. Proper notice of the tax cannot be given unless the name and address of the owner and the legal description of the tract are known. If the taxes are not paid when due, this information is needed to advertise delinquency, to give notice of sale, and to foreclose the tax lien. Proper notice to the owners or parties interested in the sale of property for nonpayment of taxes is a requirement of due process of law, and failure to give such notice affords grounds for contesting the legality of the proceedings.[5]

The main reasons for the deficiency of tract-ownership records is that real estate transfers are usually not shown on the tax books at the time they are officially recorded. To correct this situation, the official recorder should be forbidden by law from recording a transfer of title unless the instrument bears a certificate of the assessor that a record of the change of ownership has been made on the tax books. The tax maps should be revised as changes in ownership occur.

[4] "What the 1940 Census Shows About Future Population," *Real Estate*, Vol. 16, No. 37, Chicago, 1941, pp. 8-9.

[5] For cases interpreting the adequacy of land descriptions and tract-ownership records, see *People* v. *Dragstran*, 100 Ill. 286 (1881); *Otis* v. *People*, 196 Ill. 542 (1902); *Gage* v. *Waterman*, 121 Ill. 115 (1887); *Smith* v. *Prall*, 133 Ill. 308 (1890); *Miller* v. *Pence*, 132 Ill. 149 (1890); and *Gonzalia* v. *Bartelsman*, 143 Ill. 634 (1892).

The efficiency of property tax collecting has been impaired by the antiquated bookkeeping systems that are still used by local governmental agencies in most states. The record of the taxes to be collected is usually kept in a bound warrant book with a separate line for each tract. Each book contains the records for a single year, and to compute the taxes on delinquent property, it is necessary to examine the warrant books for each year that the taxes have not been paid. To complicate matters further, several computations must be made to determine the amount of penalties, interest, and costs for each year. This cumbersome method makes it practically impossible for the collector to send frequent notices to delinquent taxpayers and to use follow-up methods such as are employed by well-managed collection departments of private business concerns. Cook County, Illinois, has experimented for several years with a so-called "land-lot ledger system." Under this system, the complete record of each tract is contained on a single card, and the amount of unpaid taxes can be determined at a glance. A record of this type greatly reduces the amount of time required to compute the amount owed by a delinquent taxpayer, and it also enables the collector to employ modern collection methods. Because of its many advantages, the ledger system should be adopted generally, and office routine in the collector's office should be mechanized to the fullest extent practicable.

Installment payments for taxes are advantageous both to the taxpayer and to the government. They render the payment of the tax less odious to the taxpayer, and stabilize the flow of revenue into the public treasury. No categorical statement can be given as to the number of installments that should be prescribed; the number will probably vary in different states, depending upon the volume of taxes, and the regularity of private income. The number of installments might well vary as between rural and urban regions in the same state.

Since the proportion of an individual's income that is required for the payment of taxes has been increasing, and since the income of most taxpayers, including farmers, is spread throughout the year more evenly than formerly, careful consideration should be given to increasing the number of installments. The number of installments could be increased without markedly increasing collection costs if the improved methods of keeping records previously suggested were adopted.

Adoption of the measures that have been recommended should greatly facilitate collections, but it must not be assumed that they would eliminate tax delinquency entirely. A certain amount of delinquency is inevitable, and it is essential that appropriate devices be adopted to cope with this problem. As indicated previously, it is this step in the tax collection process that has been most neglected.

If property taxes are not paid on or before a specified date, penalties and costs should be imposed. The penalties should take the form of a flat rate applicable on the delinquency date, and additional penalties thereafter for each month that the property remains delinquent. The rates should not be so high as to penalize unduly the temporary inability of a taxpayer to discharge his obligation to government, but they should be high enough to encourage payment at the earliest date possible. The proper penalty rates would probably vary among the states, but local experience, if observed, should suggest the desirable level.

Since penalties cannot be expected to liquidate all tax delinquency, more vigorous methods must be found to enforce collection. Because of the well-known weaknesses in the personal property tax, the easiest method of solving the problem of collecting such taxes would be to exclude personalty from the general property tax. New York and Pennsylvania afford a precedent for such action. Because of constitutional barriers, however, this remedy is not possible in several states. In recent years, some counties in Illinois have used a method for the forcible collection of delinquent personal property taxes that might prove useful in other states. This method is by distress and sale of the personal property of the delinquent taxpayer under the authority of the collector's warrant.[6] The warrant authorizes the collector, in the event that any person neglects or refuses to pay his personal property tax, to levy the same by distress and sale of the goods and chattels of such person. Under this method, the collector may proceed, without court action, to distrain and sell the property. The only requirements are that the collector must give public notice of the time and place of the sale, the name of the delinquent, and the property to be sold. Under this plan, the property is sold at auction, with the requirement that, if practicable, no more property shall be sold than is necessary to pay the tax, costs, and charges due. The chief merit of the plan is obviously its simplicity. In most cases where this method has been used, the mere initiation of the proceedings has been sufficient to induce payment. The constitutionality of this proceeding might be doubtful although the issue has not yet been raised.

The most common method of enforcing real estate tax liens is that in which certificates are sold and redemption is permitted for a certain period, after which a tax deed is issued.[7] Under this procedure, lands not sold at the tax sale are forfeited to the state or county. The principal defects of this plan relate to the tax sale itself, to the validity of tax titles, and to the administration of tax-delinquent lands unsuited to private ownership. Although the tax sale operates

[6] Smith-Hurd, *Illinois Annotated Statutes*, ch. 120, secs. 651, 692, and 693.

[7] For a discussion of other methods, see *Tax Collection Procedure: Land Use Implications and Administrative Problems*, by H. K. Allen, Bureau of Agricultural Economics, 1939, pp. 22-35; and *Enforcement of Real Estate Tax Liens*, by Louis F. Alyea, Chicago Title and Trust Company, 1939.

fairly satisfactorily during periods of normal business activity, experience shows that it breaks down badly during a depression. Individuals who purchase tax liens are ordinarily actuated by the high penalties which they expect to derive from redemption of the property. They usually do not expect or desire to acquire title to the property. During a business depression many of the tax buyers refrain from purchasing the liens because they fear that the property will not be redeemed. The effect of the sale of tax liens to private buyers is that the purchasers benefit from the high penalties when times are good, and the government is forced to bear the burden of delinquency when times are bad.

The effectiveness of the tax sale and the disposition of tax-reverted lands are impaired by the weaknesses in tax titles. Because of the poor titles, genuine investors are seldom interested in the purchase of property at a tax sale. The defects in tax titles arise from the fact that the usual proceeding for the enforcement of the liens is largely administrative rather than judicial in character. Numerous statutory safeguards, moreover, have been adopted to protect the property owner in the preservation of his rights. As an illustration of the former, in Illinois a tax deed is issued by the county clerk at the termination of the redemption period without any judicial proceeding. The latter may be illustrated by further reference to Illinois. "Upon receipt of the tax deed, the tax buyer must take possession of the land or institute proceedings to take possession within one year of the date of the tax deed, and he must, moreover, pay all taxes and special assessments legally assessed for seven consecutive years. Otherwise, the original owner can secure a reconveyance of the property upon payment to the tax title holder of the amount paid at the tax sale, plus 7 per cent interest per annum thereon, together with subsequent taxes, special assessments and costs. In this case, interest is paid only on the original sale price, and the former owner is required to pay no penalties. The validity of the tax title may be contested by the original owner at any time within the statute of limitations and in the case of real property this period runs for 20 years after the tax buyer entered into possession of the lands. In the event that any minor heir, idiot or insane person has an interest in property sold at a tax sale, the property may be redeemed at any time after sale and before the expiration of one year after the termination of disability. In the case of a person mentally incompetent, the right of redemption might conceivably run as long as the person lives. The redemption right of minors and incompetents is not announced at the sale and is apparently not subject to the 20-year statute of limitations." [8]

Although a few states have set up machinery to handle forfeited lands not adapted to private ownership, most of them have made

[8] H. K. Allen, "Property Tax Collection and Delinquency," *Illinois Law Review*, Vol. 35, No. 6, 1941, p. 712.

little progress in this direction. Desirable land-use adjustments are being retarded because of a lack of facilities for the administration of our vast domain of tax-delinquent no-man's-land. The social and economic consequences of this deficiency in tax collection procedure are far-reaching in scope.

To remedy the situation, it is suggested that the tax liens be held by the county for a period of one or two years after the delinquency date of the last installment. During this period of grace, the owners would be permitted to liquidate the liens on their property by paying the taxes, penalties, and costs. Under this plan, there would be no sale of liens to private buyers; the penalties, therefore, would accrue to the government. At the termination of a specified period of grace, the delinquent tracts should be foreclosed under a proceeding *in rem*. The proceeding suggested is judicial in character, and similar to that used in the foreclosure of mortgages. The proceeding should liquidate all prior liens, encumbrances, and interests of all kinds, and create a valid fee simple title. It might be desirable to include special assessment liens in the proceeding on an equal footing with general taxes, and to divide the proceeds between the two types of liens on a *pro rata* basis.

All tracts offered at the foreclosure sale should be purchased for accumulated taxes, penalties, and costs by the county as trustee for the interested jurisdictions. The duty of handling the foreclosures should be made mandatory upon the prosecuting attorney. Knowledge that the period of grace would be followed by a vigorous foreclosure proceeding should stimulate an early payment of taxes, and greatly reduce the number of tracts to be foreclosed. To reduce the costs of foreclosure, all of the liens should be combined in a blanket proceeding.

The privilege of redeeming property sold at a tax foreclosure sale should be extended to the original owner. The length of this period should probably not be more than two or three years. At the termination of the redemption period, the property should be sold outright for a sum not less than a specified percentage of its appraised value. The minimum price should be high enough to discourage speculators from acquiring the property and to assure the retention in public ownership of lands unsuited to private use. It will be noted that the private buyer acquires good title and immediate possession under this plan. Tracts not sold for lack of buyers should be classified and converted to their most appropriate public use. In the case of rural lands, the state department of conservation or a county commission might make the classification. Urban tracts could be classified by a city planning commission or a zoning commission. Land unsuited to private ownership may be utilized for such public facilities as parks, wild-life refuges, game preserves, forests, recreational areas, and waste lands. Similar urban uses are for housing projects, parks, parking lots, and playgrounds.

TAX ADMINISTRATION IN MINNESOTA

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In addressing this meeting of the National Tax Association on the subject of tax administration, I am pleasantly aware of the fact that tax administration in Minnesota and the National Tax Association have much in common, since at least three of the tax commissioners in Minnesota, Frank L. McVey, Samuel Lord, and J. G. Armson, have also been distinguished members of this Association.

Prior to 1907, the administration of state taxes in Minnesota was considerably decentralized, following no definite pattern of organization. Tax functions were divided among several state agencies, of which the state auditor and the state treasurer were the most important. This was common to most states at the time, since tax problems were relatively simple and the need for revenue was not too pressing. By the turn of the century, increasing prosperity, expanding education, and the demand for highways, together with other pressures for increased state expenditures, made it necessary to place state tax administration upon a more permanent basis. Therefore, the legislature in 1907 established the Minnesota tax commission to be composed of three members, appointed by the Governor. This commission remained in existence for thirty-two years until it was abolished by the Reorganization Act of 1939. No analysis of tax administration in Minnesota can overlook the vital contribution made by the Minnesota tax commission. Two factors, it seems to me, account for the excellent record of the commission: the high quality of most of the men appointed to it, and the long service of some of the commissioners. This latter factor tended to give a continuity of policy and administration not frequently found in the three-man type of tax commission.

The 1939 legislature effected a number of changes in the state government, including the establishment of a department of taxation under a single tax commissioner, appointed for a term of six years by the Governor, in place of the three-man tax commission. This change was in no sense a criticism of the operation of the Minnesota tax commission, but should be viewed rather as a part of the general trend in state government toward greater centralization of tax administration and revenue collecting function. The 1939 legislature also transferred to the new department of taxation three tax-collecting functions not previously performed by the Minnesota tax commission: namely, gasoline taxes, gift and inheritance taxes, and cigarette licenses. The 1941 legislature turned over the administration of the new bank excise tax to the department, but allowed the chain store tax to expire, and returned the collection of cigarette licenses to the local governments.

In order to facilitate the description of the functions and duties of the Minnesota department of taxation as they are at present, I will discuss them under the following headings: revenue collection, supervision of local tax officials, and miscellaneous activities.

Quite naturally the most important function of the department from the point of view of number of employees engaged in it is the function of collection of revenue. As of July 1, 1941, the department of taxation was responsible for the collection of the following taxes: income tax upon individuals, corporations, and fiduciaries; gasoline tax; bank excise tax; gift tax; inheritance tax; occupation tax; royalty tax; and the certification of gross earnings taxes upon railroad, telephone, telegraph, express, freight line, sleeping car, and trust companies. All of the 234 employees of the department were engaged wholly or in part in duties involving the administration or collection of these taxes. The total revenue from all these sources for the fiscal year ending June 30, 1941, was $48,812,730. This amount represented 63 per cent of the revenue from state taxes and 27 per cent of the total revenue from all levels of government in Minnesota. In 1907, the first year of operation of the Minnesota tax commission, the commission collected no taxes, but was responsible for the certification of the railroad gross earnings tax. These certifications totaled $3,270,337, which amount represented 29 per cent of state revenues and 12 per cent of the total revenue of state and local governments combined. In 1939, the last year of operation of the Minnesota tax commission, the total amount collected by the commission was $18,815,454, which amount was 30 per cent of all state tax collections, and 11 per cent of all revenues combined. Although the Minnesota tax commission's collections in 1939 were six times as large as they were in 1907, relatively, the Minnesota tax commission's position as a central revenue-collecting agency had remained unchanged. This failure of the Minnesota tax commission's collections to grow in relation to the total tax structure of the state can, in the main, be accounted for by two factors: first, the rate of increase in the property tax revenues of local governments was greater than the rate of increase in the commission's revenues; and second, the rapid increase in state tax collections of state agencies other than the commission.

While the larger part of state tax revenues are now collected by the department of taxation, it should be noted that not all state taxes are centralized in this department. Motor vehicle license laws are administered by the secretary of state; liquor stamp taxes are collected by the liquor commission; gross premiums and fire marshal taxes upon insurance companies are collected by the insurance commissioner; hunting and fishing licenses are collected by the department of conservation; a vessel tonnage tax is collected by the state auditor; and the state's share of the property tax is collected by county treasurers throughout the state. Total revenue from these

sources during the 1941 fiscal year amounted to $29,141,750 which represented 37 per cent of the state's revenue and 18 per cent of the total revenue of state and local governments combined. In summarizing this discussion of the revenue-collecting activities of the department of taxation, two facts should be emphasized: first, the collection of nearly two-thirds of Minnesota's state taxes, which represents 30 per cent of the revenues from all levels of government in Minnesota, is centered in the department of taxation. Second, revenues from state taxes have increased in relative importance in the state's tax structure, rising from 10 per cent of all tax revenues in 1907 to 43 per cent of all revenues in 1941.

A second group of activities in the department centers around the relation of the commissioner of taxation and the department of taxation to the tax officials of the local governments in Minnesota. The relationship between the department and the local tax officials is based upon the common interest which both have in the administration of property taxation. Before I discuss these activities, however, I would like to digress for a moment and present a brief description of Minnesota's property tax structure, since I believe that there are certain aspects of it which differ from the property tax systems of most other states.

Minnesota has a classified property tax, the first classified assessment law having been passed in 1913. Under this system of property taxation, all property, both real and personal, is valued by the assessor at its true and full value, and then the assessed value, for mill rate purposes, is arrived at by multiplying the full and true value of each class of property by a certain percentage. The classes of property, and the percentage of full and true value to be used are determined by the legislature. Beginning January 1, 1942, the following classes of property and percentages of full and true value will be in effect:

Class 1.	Iron ore, mined or unmined	50%
Class 2.	Household goods	25%
Class 3.	Unplatted real estate, merchandise, manufactured articles, work materials and equipment	33⅓%
Class 3a.	Agricultural products in the hands of the producer	10%
Class 3b.	First $4,000 of full and true value of unplatted real estate used as a homestead	20%
Class 3c.	First $4,000 of full and true value of platted real estate used as a homestead	25%
Class 3d.	All livestock, agricultural tools and machinery used by the owner in any agricultural pursuit	20%
Class 4.	All other property (principally urban real estate)	40%

It should be noted that the homestead classification is an attempt by the legislature to reduce the tax burden upon real estate used as a place of residence by the owner. It is not similar to the homestead exemption laws in other states, therefore.

A second unusual feature of Minnesota's property tax system is with respect to the equalization of valuations placed on property by the assessor. When the township or county assessor has placed a value upon the property in his district, these valuations can be changed by the local boards of review since these boards have the authority to equalize valuations between individuals within the assessment district. Then these values which have been equalized by the boards of review are in turn subject to equalization by the county board of equalization. The county board of equalization has the power to equalize assessment values between individuals and between taxing districts in the county. The values which are equalized by the county board are then subject to further equalization by the state board of equalization. This state board has the authority, not only to equalize assessment values between the counties, but also has the authority to equalize valuations between townships, cities and villages, and individuals. As can be seen, this system of cumulative power of equalization places a great responsibility upon the state board of equalization. A further unique feature regarding equalization in Minnesota is that the commissioner of taxation has the power to sit as the state board of equalization. This extraordinary situation arose when all of the powers vested in the Minnesota tax commission were transferred to the commissioner of taxation. In exercising its authority as the state board of equalization, the Minnesota tax commission established the precedent of having the commission value the real and personal property of iron ore mining and public utility companies. While there is nothing in the law to prevent a local assessor from placing a valuation on these properties, the final equalized valuations were determined by expert appraisers in the commission. This policy has been carried on by the department of taxation so that in effect the assessment of mining and public utility properties is done by the mining and public utility divisions of the department, and not by local assessors, as examination of the assessment laws of the state would seem to indicate.

The third respect in which Minnesota's property tax system differs from the usual state property tax is in respect to the taxation of money and credits, i.e., cash, stocks, bank deposits, etc. Since 1911, Minnesota has had a money and credits tax of three mills on such items instead of taxing them as personal property.

While these brief statements concerning certain features of Minnesota's property tax system do not cover all features of our property tax, I hope they will serve to give some idea of the differences between Minnesota's property tax administration and those of other

states. I would like to turn now to a description of the relationship of the department of taxation to local tax officials. A description of this relationship will perhaps be facilitated by discussing the subject under the following headings: equalization, reassessment, money and credits, assessors' meetings, and property tax records and forms.

As I have already indicated, the commissioner of taxation, since he also acts as the state board of equalization, has the authority to equalize the valuations of all property assessed in the state. Since there are over twenty-eight hundred local taxing officials, with boards of review in each taxing district, and county boards of equalization in each county, it can be seen that the work of equalizing the values placed on the assessment rolls by these officials is tremendous. In order to carry out this function, the department of taxation requires local tax officials to provide it with detailed information on the valuation of property in each county. The state board of equalization holds its first meeting the second Tuesday in September, and the commissioner and his advisory staff continue in that capacity until equalization is completed and all equalized assessments of property have been certified to the county auditors. A discussion of state equalization would not be complete without mentioning the equalization of iron ore mining property and public utility property. The mining division of the department with its staff of mining appraisers and engineers is in operation the year round in order to assess the iron ore properties of the state. (This division also has the responsibility for the certification of iron ore royalty and occupation taxes.) The magnitude of this assessment can be seen when it is realized that the total assessment of real and personal property of iron ore companies in Minnesota amounted to $182,745,451 for 1940. The electric and hydraulic engineer of the department is also on a full-time basis, and has the responsibility for valuing all privately owned public utility property. The total valuation of these properties for 1940 amounted to $37,250,928.

A second point in the relationship of the department of taxation to local tax officials arises from the responsibility of the commissioner of taxation for ordering reassessments in cases where property has been unjustly assessed. For this purpose, the department employs a full-time appraiser whose work is supplemented from time to time by the work of temporary appraisers. A number of reassessments were made by the department in 1939 and 1940, the largest activity of this kind being the reassessment of all real estate in Faribault, a city with a population of fifteen thousand.

The third relation between the department and local tax officials arises from the authority of the department to supervise assessments of money and credits. The money and credits division was established early in 1940 with a three-fold purpose: first, to gather information on the taxation of intangibles in the state; second, to secure the cooperation of local tax officials in improving their assessment

of such intangibles; third, to discover omitted personal property and order such property to be placed on the assessment rolls. The division has been very successful in accomplishing these ends. Total assessments of money and credits were increased $51,000,000 in 1940 over 1939. This increase compares favorably with an average annual increase from 1911 to 1939 of $23,000,000. The department, through the money and credits division, ordered special assessments of omitted money and credits property of over $12,000,000.

Fourth, the commissioner of taxation has the power "to confer with, advise and give the necessary instructions and directions to local assessors throughout the state as to their duties under the laws of the state . . ." In carrying out this responsibility, the department holds annual assessors' meetings for the purpose of improving the standards of assessment throughout the state. In addition, the commissioner and his deputy are required to visit each county in the state at least once in every two years to check on the work of the assessors.

Finally, the supervision of local taxing officials by the department of taxation extends to the prescribing of the forms for assessment rolls, real and personal property abstracts, and tax levy abstracts. It should also be mentioned that a considerable amount of time is spent by the staff of the department in answering questions of local tax officials on matters relating to exemption of property, imposition of penalties, etc.

In addition to the revenue collecting and supervisory functions of the department of taxation, there are several activities of the department which are of a related character, but are important enough to merit separate consideration. I refer in particular to abatements, tax deeds, and tax hearings. Among the broad powers granted to the commissioner of taxation is the duty "to hear and determine all matters and grievances relating to taxation," and the power to grant reductions or abatements of assessed valuations or taxes. Consideration of applications for abatement of taxes and offers of settlement constitute one of the major activities of the department. The number of such applications has averaged over 20,000 in the last two years. It is also the duty of the department to make out tax deeds for tax-forfeited property which has been sold by the state. Nearly 8,000 of these deeds were issued by the department last year. Whenever a taxpayer is not satisfied with an order issued by the commissioner of taxation, he can demand a formal hearing before the commissioner. A considerable amount of time on the part of the commissioner and his deputy is spent on conducting these tax hearings and rendering decisions.

At this point, it is pertinent to note that the Reorganization Act of 1939 established the board of tax appeals as an appellate agency to review the decisions of the commissioner of taxation whenever taxpayers appealed from those decisions.

In order for the department to perform the great variety of duties and functions assigned to it, considerable thought has been given to the internal organization of the department. At present it appears that a combination of line and staff organization is the most workable arrangement. Two staff divisions have been established, the legal division and the tax research division, and in addition, three officers of the department, the deputy commissioner, the secretary, and the administrative assistant, act as both staff advisers to the commissioner and administrative officers within the general administrative division. Below the staff level, the department has been divided into four administrative divisions: income tax division, petroleum division, gift and inheritance, and general administration. The income tax division is directly under the supervision of the commissioner, while the petroleum division is directly under the supervision of the deputy commissioner. All activities, other than income tax, gasoline tax, and gift and inheritance tax, have been placed in the general administrative division. Within this division, the remaining various functions and duties of the department have been allocated to the four principal administrative officers: namely, the commissioner, the deputy commissioner, the secretary, and the administrative assistant.

In concluding this statement of tax administration in Minnesota, it seems to me that three facts stand out: first, the creation of the department of taxation has effected a considerable centralization in the collection of state revenue. Second, a large degree of state supervision and control of local tax officials and property tax administration exists in Minnesota. Third, in the relationship between the commissioner of taxation and local taxing officials, there exists a singularly potentiality for further integration of property tax administration in Minnesota.

THE WORK OF STATE TAX COMMISSIONS

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When I was asked to give a critical appraisal of the work of state tax commissions over the period of the last decade, or longer, I was told that the assignment would doubtless involve a considerable amount of labor and might even necessitate the summoning of some degree of courage. I can attest to the amount of labor that might have been involved had I had more time at my disposal, but even so I examined many of the annual and special reports of the tax commissions of most of the states and shall have some critical comments to make concerning some of them.

One method of procedure might have been to list the various annual, biennial or special reports which have emanated from differ-

ent commissions and thus, through some form of quantitative measurement, reach a conclusion as to which commissions have actually been making progress, which have been "backsliding", and which have simply been maintaining their *status quo*. Could this sort of measurement be considered adequate, the research part of the assignment has already been admirably done by Professor Lewis W. Morse, Librarian of the Law School of Cornell University, and is being made available in a series of articles published by the Commerce Clearing House in *Taxes*. The series is nearing completion and in it one may find for each state the legislative authorization for state tax boards which preceded the tax commission, the authorization for special commissions as well as the tax commission, and a list of the publications of the different state commissions.

Merely to note the number and size of reports, however, is hardly an adequate index of the initiative, activities and accomplishments of our state tax commissions. I propose, then, in my few remarks to set up some standards which I think desirable for effective work in a commission, and to note some accomplishments which I think may be taken as indices as to the effectiveness of its work. Obviously it will be impossible to make an application to the commission of each state, but, for purposes of illustration, the work of some commissions will be examined. The inclusion or omission of the commission of any state is no indication that it was not worthy of credit or free from censure, but merely that it did not happen to be chosen to illustrate the point under discussion.

PERSONNEL

One of the important essentials to the effective work of the commission of any state is the qualification and permanency of the members of the commission and of its staff. It should hardly need to be said that some training in matters of taxation, and especially some intimate contact with the administrative problems of the state, are qualifications which one would have a right to expect of any one appointed as a tax commissioner. Even if I desired to analyze or psychoanalyze the members of present state tax commissions on the basis of essential qualifications, in the first place it would be impossible to get reliable data in all cases, and in the second place it would probably be unsafe to make some statements that would have to be made. If it should become necessary to say that Commissioner so-and-so had obviously had no training in any way to fit him for the work of a commissioner and had obviously been appointed because of his political activity and support of the governor in his campaign for election, well, it might just be unwise to make such a statement, and still more unwise if it should become necessary to make the statement about each of the members of the commission. While I consider the effective work of a commission definitely dependent upon the training and capacity of the members, I shall

attempt no analysis on this score, but I shall simply suggest that perhaps in some states lack of progress, or even regression, may be laid to the personnel of the commission.

To insure satisfactory results, guarantee of some permanency of tenure must supplement proper qualifications; in fact, in some cases it must be a prerequisite to it because uncertainty of tenure may preclude acceptance. Here again, no comparison of specific commissions will be made. When one discovers that for year after year, through one administration after another, the same commissioners continue to function, he can assume that conditions exist which make for systematic and progressive work; on the other hand, if he finds that at the end of an eight-year administration of a governor, not one of the original appointees continued to serve, while within this period at least seven different appointments were made to a three-man commission, well, he has a right to question whether satisfactory accomplishments may be expected. I am not unmindful of the fact that the suggestion of permanency may not harmonize with the notion that, under a party system, members of the tax commission should be political appointees. Yet I doubt whether we can harmonize competence and effectiveness with some of the political appointments that have been made.

While a competent and adequate research staff cannot be offered as a substitute for a commission, yet it is an indispensable adjunct to a poor commission as well as to a good one. Give a poor commission a research staff with a competent director and the staff may accomplish much that should be expected of the commissioners. Without such a director, with freedom of initiative and action, little will be accomplished. With qualified commissioners to guide the work of research, the maximum in accomplishment may be expected.

A satisfactory research staff can exist, it should hardly be necessary to point out, only through competency and assurance of permanancy of tenure. I suspect, however, that investigation would reveal instances in which research and clerical staffs were but the avenues for the payment of political debts, and that neither competency nor permanency of tenure resulted. Accomplishments do not warrant the costs and only condemnation can be voiced where such conditions prevail.

PUBLICATIONS AS EVIDENCE OF ACCOMPLISHMENTS

One evidence of the type of work which engages a tax commission is its publications. These may take the form of an annual or biennial report, special reports and the results of different types of research. The contents of the publications give some indication of the activities of the commission. It will be impossible, of course, to analyze the publications of the commissions of every state, but we can note those of a few states as evidence of activity or lack of it.

Since I am more familiar with the Illinois Commission than that of any other state I may start by saying that the publications of the last few years indicate considerable vigor and activity. Before 1928, however, the annual reports of the Commission constituted practically the entire published material, while the contents of these consisted largely of a record of the routine work of the Commission supplemented by statistical presentation of assessment data.

In the report for the assessment year 1928 the statement is made that: "in the presentation of this report the Commission has embarked upon a new policy. It has attempted to describe the tax system in such a way that the legislator and the taxpayer can quickly find the essential information concerning the tax system of Illinois." While the report is superior to previous ones, it falls far short of the above statement of purpose. With one statement in this report I want here to register violent protest because I feel it represents an inherent weakness of many attempts at tax administration. To quote: "No attempt has been made at refined theoretical analysis; rather the effort has been made to discuss the practical defects . . . and to provide some solution for existing difficulties." I have continued to say, and want to reiterate it, that many of our administrative problems arise because what we are trying to administer is unsound in principle. I do not say that we can ever evolve a tax system which will be free from administrative problems, but I do say that if we give our first concern to the soundness of the principles involved, administrative problems will be less formidable and obstinate.

The report for the assessment year 1933 marks a high light in the reports of the Illinois Commission. The glaring defects in the Illinois tax system are set forth in no uncertain terms. One or two successive reports reiterate these defects or make reference to the previous report, while the reports of the last four years, published as biennial reports, are much less vigorous in their protests. In addition to the annual reports, other publications of the Commission indicate activity in the realms of administrative assistance and research. The *Manual for Assessors* has proved of great assistance in securing a greater uniformity in the assessment of property. Especially in the assessment of the capital stock of corporations have the suggestions of the Commission been very valuable. The reports dealing with tax rate limitation were of a high order. In addition, an elaborate research program, *A Survey of Local Finance in Illinois* has been under way. Eight volumes have already appeared while three others are in the course of preparation. The *Special Report No. 5*, which is the Proceedings of an open forum on taxation and tax problems in Illinois, is worthy of favorable comment. All in all, then, on the basis of increased supervision of assessments, analysis of problems in annual reports, and in the type of research which has been in progress, the Commission in Illinois

may be taken as an example of one which has made distinct progress in the last decade.

The work of the Commission of the State of New York has always been recognized as outstanding. The successive annual reports emphasize current and unsolved problems, but once solutions are secured they are looked upon as *fait accompli* and attention is directed elsewhere. In the most recent report most emphasis is centered around the problem of interstate trade barriers. As in the discussion of other problems by the Commission, attention is centered around the basic principles involved and around the economic consequences of the extension of such barriers. The annual reports continue to be supplemented by many bulletins designed both to instruct and to assist in administrative procedure. As examples of recent bulletins those explaining the law relative to the assessment of real property and instructions for preparation of assessment rolls may be mentioned. The series of special reports, which have resulted from the grant of fellowships by the Commission to graduate students in different universities, must receive general commendation. Each volume published represents a definite contribution towards the solution of some problem in taxation as it confronts not only the state of New York but other states as well. The information that this work will be discontinued will be regretfully received by those who have anxiously awaited each successive volume in this series.

Two other states may be mentioned, the publications of which indicate considerable activity on the part of the Tax Commissions. From the beginning the reports of the Oklahoma Commission have given an excellent presentation of its work and of the finances of the State. In addition, an extensive program of research has been carried on resulting to date in the publication of thirty-nine bulletins which deal with many different phases of the State's finances. As an educational program the commission has published a series of bulletins called "Know Your Government Series." These contain a frank and simple discussion of the problems which should be of most vital concern to the average citizen. The commission in the state of Mississippi is engaged in publishing a series of "Service Bulletins." The caption under which the series appears is: "Get the facts—uninfluenced by politics, prejudice or propaganda; we study the problems which others discuss." The contents and method of presentation should be of interest to officials and to particular groups but would hardly be of much use to a general layman even though his attention were called to the bulletins.

In contrast to the conclusions just presented, the evidence at hand indicates that the commissions in some states have not maintained the initiative and vigor which formerly characterized their activities. This can hardly be accounted for through a satisfactory solution of all the problems of taxation. A study of the reports of the commis-

sions of both Minnesota and Wisconsin, for example, over the last decade seems to indicate that the commissioners are becoming less concerned with the problems involved. More and more the contents of the reports have taken the nature of a compilation of statistical data which, in the method of presentation, can be of little general interest. It is to be regretted that commissions in states which were formerly looked upon as leaders should assume a lethargic attitude towards their current problems of taxation.

It should be pointed out that in some states the tax commission has never assumed a very active role and has made little progress from this position. In many cases the entire publication of the commission consists in the annual or biennial report, the contents of which consist of page upon page of statistics of valuation. No evidence is presented as to how the valuations were determined or as to their justification; neither is there any indication that any problems exist. Commissions which to some degree fall into this category are those in New Jersey, Louisiana, Indiana, Connecticut, New Hampshire, and Oregon, as well as others.

One observation should be made which in some cases may mitigate some of the above criticisms. In some states considerable activity beyond the realm of the commission has been shown in matters of taxation. Witness the number of studies which were made by specially authorized committees or commissions for the years following 1925. Such studies may be properly considered as supplementing the work of the regular commission, but the findings should only act as a stimulus to the commission to bring to a realization many of the recommendations found therein. It is very possible, moreover, that some commissions devote much energy to supervision and administrative activity, the results of which do not appear in publications. While such activities are to be commended, yet they alone should not comprise the entire accomplishments of an ideal commission.

LEGISLATIVE ACTIVITIES

The state tax commission, properly constituted and activated, should be the dominant factor in securing desirable changes in the tax system of a state. First, the need for the change must be clear, and the commission must feel free to press for its adoption in spite of the opposition of strong pressure groups. It is disheartening to find in the report of a commission a scathing denunciation of an undesirable practice, with perhaps suggested legislation to remedy it, then in later reports to find no mention of the evil although the practice still exists. One is constrained to wonder just what has happened. Merely to publish in a report that undesirable conditions exist is not likely to accomplish much in the way of reform. It may be assumed that a copy of the report is sent to each member of the legislature. It cannot be assumed, however, that each member will

read it, or that he will take the contents very seriously even though he does read it. Many legislators may know little about problems of taxation or may be too much concerned with other things to take very seriously the contents of a report of the tax commission. The same may be said for the findings and recommendations in many of the excellent special studies that have been made in different states. They have been acknowledged as good studies, copies have been sent to different commissions and libraries but, so far as accomplishing any actual change, the results in most states has been disappointing.

The situation in Illinois may be taken to illustrate this condition. As indicated above, reports of the commission of a few years ago, as well as studies made by special groups, revealed glaring defects in the system of taxation. To correct some of these a change in the constitution may be necessary, but in some cases legislative enactment is all that is needed. From all indications the commission has not exerted much energy in attempts to secure corrective legislation.

The Tax Commission occupies a strategic position in the finances of the state. Because of its administrative responsibilities and facilities for research it should be more conversant with the defects and needed reforms than any other group. The members should be immune from the influence of any pressure group or political favoritism. If we cannot look to the tax commission for militant leadership in securing tax reform, upon what group can we rely to accomplish it? Of what use is it for a commission, through expensive research, to find that serious defects exist, if it is unwilling to exert active leadership to see that they are corrected? Those commissions which adopt a passive attitude in such matters are failing to render an important service to the people of their state. After all, the commission should strive for a defensible tax system rather than one which will receive the approbation of any particular group.

RELATION TO PUBLIC

In the end it is the taxpayers of the state who are most interested in the problems of taxation; or, at least, they should be. The evidence indicates that the commissions of most states have done little in recognition of this interest or in attempts to cultivate it, useful and valuable as it may be in support of any legislative program. Most publications of commissions are not of a nature to be of interest or intelligible to the layman. In most cases no attempt has been made to inform the public of the activities of the commission or to enlist its support. The results of a poll taken in almost any state to find what the general public knows about the work of the tax commission would be interesting, and probably discouraging. As noted above, the commission of Oklahoma has recognized the

desirability of an enlightened public and is seeking to accomplish such enlightenment through its series of "Know Your Government" bulletins.

The people of the state have a right to know the condition of the finances and to be conversant with the problems involved in the system of taxation and with the other problems which may be related to it. Certainly if any state board can logically be held responsible for this public relationship it is the tax commission. Reports which are attractive, interesting, and yet which set forth the facts and problems connected with the state's fiscal machinery can be prepared for public consumption. Many groups are anxious that such materials be used in study groups and otherwise. Close co-operation with local taxpayers' associations, chambers of commerce, leagues of women voters, parent-teachers associations, and similar organizations can be mutually beneficial. The support of an enlightened constituency is very helpful in any attempt to procure a desired change in the tax system.

The evidence indicates, then, that few, if any, tax commissions have availed themselves of all the opportunities which the strategic position they occupy presents to them. Only as the members take the initiative to serve the people in the different capacities outlined above, will the expression "State Tax Commission" convey the full significance that it should.

NINTH SESSION

Tuesday, October 14, 1:30 P. M.

Luncheon Session

Coffman Memorial Union
University of Minnesota

Walter C. Coffey, President, University of Minnesota, presiding.

Chairman Coffey: It becomes my happy privilege to welcome the delegates of the National Tax Association and Conference to the University of Minnesota. We are most pleased to have you spend one day of your sessions with us. You know, for the last 20 years I have been extending welcomes to one sort of group and another, and it has come to the point where I am perplexed as to what I ought to say, so that I can scarcely find words to say anything.

One time I welcomed the State Rural Editors' Association at the University Farm. That is on another campus not very far from here. I told those people how happy we were to have them, and then I went ahead to tell them how very important they were in the life of the state, how they helped to mold public opinion, how they helped to educate the people as a whole, and I spent a lot of time telling them how important I thought they were. Then I finished by saying that I welcomed a small group of well drillers the week before, and I tried to make them think that they were equally important. So everybody is important, one way or another, but I am tremendously impressed by your importance.

You are a national organization, holding your thirty-fourth annual meeting. You have prepared an extensive program, and I notice, according to the rules of your game, that a man is only allowed so many minutes in which to present a paper, and a person who is called upon to discuss the paper has only so many minutes in which he may speak, unless he is given permission for additional time from the floor. I just wonder whether they ever get that permission or not.

So you are truly a very important body, and especially at this time, when the subject of taxation looms larger in the national picture, and the local picture as well, than ever before.

I am not going to stand up here and try to talk to you about taxes. I know a little about them from personal experience, not very much. I am going to exhibit my wisdom by not saying anything on the

subject. But I will say to you that we as a university have exhibited an interest, I think, in the subject of taxation, and we have men on our staff who are more or less expert in certain fields of taxation. If I had time, I could relate to you a number of studies that we have conducted here, most of them within the past ten years, which I think has made a real contribution to this field of study. You are acquainted with a number of our men, and you are able to judge of their ability and of the product they have produced.

I do not know that we are any more outstanding in that matter than many of the other universities represented by the delegates to this conference. Since I have decided not to say anything at all about taxation, I thought I might say a word or two about this building in which you are sitting. It is known as the Coffman Memorial Union, and I have brought with me a statement that I used in talking to the alumni of the university a week ago tonight.

The purpose of the building was to provide a social center in which student activities could be focused. It must be recognized that even in a milling state like this men do not live by bread alone. The Union houses all the student organizations, and there are many of them. I will not attempt to enumerate them. It is the center of all student meetings. In addition, the Union has on its staff two program consultants, a man and a woman, whose function it is to coordinate student programs, and to develop programs for the Union itself. The range of their programs is wide, for they are designed to fit the interests and needs of all types of students. There are dances, hikes, dancing instruction, motion pictures, art exhibits, music hours, and so forth.

The Union also houses the student post office, which in itself tends to act as a magnet drawing students to the building. The building was dedicated a year ago this month, although it was actually opened in September.

The heart of the building is the main first-floor lounge, which was photographed for a *Post* article, and I suppose that a number of you saw that article. In the room are two portraits presented by the staff, one of President Coffman, the other of Mrs. Coffman. Both were painted by John C. Johansen, a distinguished portrait artist of New York City.

The real thing I wanted to tell you about this building is the manner and extent to which it is being used by our students. It is a very ambitious undertaking, and I was one of the doubting Thomases wondering whether it would be used by our students to the extent that we find it is. One has to see this building day by day to appreciate the extent to which it is used and appreciate the effect it has on campus life.

A special count for a week, and a week in no way unusual, shows that an average of 14,000 persons use the building per day. There is, of course, some duplication. During 1940-41, 170,000 people

attended meetings in the various conference rooms, primarily students and faculty. The dining rooms of the building, excluding the campus club, which is for faculty, serve an average of about 7,000 meals a day. Eighty-one thousand persons were served in the private dining rooms last year. All told, more than a million meal checks were paid in the first year of operation. Sixty-one thousand people, chiefly students, attended special programs arranged by the Union. There were 2,200 borrowings from the Union's loan collection of phonograph records. So this Union tends to pull the entire student body together, to unify the different colleges on the campus, and with all is serving a most useful function.

Financially, the building is carrying itself. No state funds went into it, and none are used in its maintenance. The two million dollars for construction came from a grant of 45 percent of WPA, from funds subscribed by alumni staffs, students, and funds of the university, some athletic and other university funds, and a bond issue of $400,000. Already the regents have reduced by $75,000 the money borrowed to meet the construction costs.

I hope you will pardon me for saying something about this building, which is unusual, for us, at least, and I think it serves in one way to indicate the size and variety of interests represented in the university, and, after all, a group of young people of 12,000 or more, with all the people attending, rendering service of various sorts, make a city of no inconsiderable size.

Once more, I wish to say that we are so glad to welcome you here today. If there is anything we can do for you, if you want to be conducted through this building, or anything else you would like to have, we will do our best to serve you.

Now I am calling upon Dean Russell Stevenson of our College of Business Administration. He can speak your language, and he can give you the sort of welcome you can understand. Dean Stevenson.

DEAN STEVENSON: It is a pleasure to welcome the National Tax Conference to the University in behalf of the faculty of the School of Business Administration. Your meetings here today will contribute much to the enrichment of one of the major fields in the curriculum of the school. Taxation and public finance are included in the courses of study for all undergraduates and all candidates for the Ph.D. degree in Economics take at least one graduate seminar in the field.

The principal reason why emphasis is placed on these subjects here more than in many other institutions is due to our good fortune in having Professor Roy G. Blakey as a member of the staff. You are acquainted with him through his published works. The reviews of the successive federal income tax acts, under the joint authorship of Professor and Mrs. Blakey, have become standards of

reference for everyone interested in the field of taxation. Their historical survey of the *Federal Income Tax* recently published is an invaluable source book for students of public finance. To his colleagues here at Minnesota Professor Blakey is recognized not only as an authority in taxation, but also as a wise counsellor and an inspiring teacher. His relationships to various public agencies and civic groups as a counsellor have contributed in many ways to the formulation of tax legislation in Minnesota and in other states. His views are sought by taxpayers' groups as well as by legislative committees and administrative agencies. He has, in fact, the confidence of groups many of whom have conflicting interests.

The fact that an economist is called upon for advice and counsel by different groups having widely divergent views should not be a matter for special comment. As an independent scholar his findings should be of just as much significance to one side as to the other in any controversial question. Economic facts and the analyses based upon them are, or should be, the same regardless of the uses to which they may be put. There is no more reason for the existence of several "brands" of economics than there is for different "brands" of chemistry, physics, or other sciences.

Unfortunately, there appears to be developing a tendency to classify economists in terms of their attitudes toward current problems. Thus we hear of the pro-New Deal economists, the conservative economists, and perhaps even the reactionary economists. This has come about in large part as a result of the pronounced increase in the use of economists in government service and in business. Formerly economists had, like their colleagues in other divisions, been cloistered scholars seldom heard or seen outside of college halls. The professional economist as a potent force in public affairs is largely a product of the past ten years.

The introduction of the economist into the administrative departments of government has been a good thing. Certainly the conduct of many governmental administrative agencies has been greatly strengthened by the addition to their staffs of eminent economists. This is particularly true in those divisions of government whose activities involve the formulation of policies of an economic character. The very fact of his connection with a government department, however, is bound to have an influence upon the published results of his studies. He may be quite free in formulating and expressing his opinion prior to the adoption of a specific policy by the administration. Once the specific policy has been approved and adopted, however, he is hardly free to report publicly on his observations from a strictly detached point of view. He becomes, if not a protagonist, at least an apologist for a specific program. He is, in fact, and should be, a defender of the policies of the administration. His activities as an independent scholar are thus definitely circumscribed.

Likewise, the economist employed by a business concern is limited in his work as an independent scholar. He becomes recognized to the outsider as a pleader for the interests of his company. He is identified with the interests of the particular business institution with which he is associated. There is nothing improper about such a relationship. In fact, it is highly desirable that business obtain the best possible talent to present its case.

I do not mean to imply that economists employed by government or by business are incapable of being objective. It is the existence of circumstances which identify them with specific points of view that makes it appear that their conclusions are somewhat biased. Furthermore, it is impossible to establish conditions so free from political or other pressures within a governmental agency or business concern that they will compel the confidence of all interested parties.

It is highly desirable, however, to have a group of scholars who are clearly independent of all such pressures. Our universities afford the best possible setting for the independent study of economic problems. In these institutions we may find the conditions which make for confidence, such as, permanence of tenure, the conditions of work, continuity, opportunity of dealing with problems as a whole, possibility of surveying of a wide field extending beyond the limitations of specific agencies, localities, or institutions. So long as our universities provide conditions for the study of social problems similar to those provided in science, we will have a source of productive ideas bearing upon the conduct of our economic institutions. Given adequate financial support, we may confidently expect results comparable to those which have been attained from scientific research in medicine, engineering, the technical arts, and in agriculture.

The difficulties of maintaining appropriate conditions for objective study of economic problems are many and varied. Not the least of these is the competition for the most capable scholars by government and business. They have both been making inroads upon the faculties of many of our leading institutions. There is much to be gained from relatively short leaves of absence from the university for scholars to work upon specific problems in a government department or a business office. The student of economic affairs should not be completely isolated from the practical problems of administration. He often needs the data from records for the study of some problems that would be available to him only as an employee. These excursions from the academic environment, however, should be of short duration, just long enough to enable him to present his contribution to a specific problem and to secure the experience and factual material needed for his own research work. In no way may those in government and in business make more sure of a continuing body of materials bearing upon the problems of

modern economic life than by doing their part to insure our universities the means in both funds and personnel to carry on the scientific investigations that are essential to the development of an improved economic organization of society.

Again may I welcome the members of the Conference to the School of Business Administration. We here are trying to maintain the conditions for independent research and are struggling to keep our faculty intact. It is difficult to withstand the many pressures for their services outside of the institution. I hope you will visit us in Vincent Hall, where there are several significant research projects in economics now in progress.

CHAIRMAN COFFEY: Thank you, Dean Stevenson.

As a very young man, the next speaker assumed a heavy responsibility in his native state, Utah, heavy responsibilities in the fields of business and banking, and there he made a most enviable record. He is a man who is unusually well equipped mentally—he is an untiring worker, he has great courage, he is not a defeatist, and he has a basic program to which he consistently adheres.

At this time it gives me very great pleasure indeed to introduce a man who in addition to all of this is a good fellow and a fine companion, Marriner S. Eccles, chairman of the board of governors of the Federal Reserve System.

MARRINER S. ECCLES: Thank you, President Coffey.

Members of the National Tax Association: It is a privilege to me to have the opportunity of addressing such an outstanding and distinguished group of experts. I feel that the importance of this group is such, and my own public position is such, that I am unable to address you as informally as I should like to. I have therefore prepared a statement expressing some of my views, and I hope that in the consideration of it you will not be too critical, without realizing that we are possibly living in the most evolutionary if not revolutionary period in the history of this country, if not in the history of the world, and it is going to take a lot of imagination and a lot of courage to see our way through to the future.

It has not been my privilege heretofore to speak before an audience of tax authorities. While I am grateful to the National Tax Association for inviting me, I am merely a banker and business man and I stand in awe of the tax expert. I have glanced over the record of some of your past proceedings and I am impressed by the breadth and scope of your deliberations and by the learning displayed by your speakers. While I cannot hope to add to your technical enlightenment, I am venturing to outline to you some of the broader national aspects of taxation in relation to fiscal and monetary action that, in my judgment, are of the greatest importance to this country now and in the future. In what I have to say I am, of course, speaking only for myself.

For a long time I have been interested in making fiscal policy play its proper part in a broad program for maintaining that orderly economic progress that ought to go step by step with the steady growth in our human resources and in our technical knowledge. Except during major wars, our state and local governments have until recently been much more important from the financial point of view than the federal government. Although federal revenues and expenditures have greatly expanded during the past decade, it is only since the beginning of the defense program that federal expenditures have begun to exceed aggregate state and local expenditures. It is only in the current fiscal year that federal taxes will exceed aggregate state and local taxes. No one who is interested in a more intelligently planned fiscal policy for the nation as a whole can fail to take account of the financial problems of our state and local units of Government, and of the vast complex of taxing jurisdictions numbering more than 175,000.

The principles that should govern present policy are simple. If we are to attain the broad objectives of our present national policy, expenditures for defense must absorb an increasingly large proportion of our national income. This general policy is, of course, easy to state, but difficult to apply. Our people—business men, labor, farmers—are still thinking mainly in terms of the profits they hope to make rather than of the sacrifices which will be required of all groups of our population. As yet our standard of living has not suffered and relatively few dislocations have resulted. In some localities where there have been sudden large increases in population due to the expansion in defense industry, the strain of providing adequate public services is severe, but in general state and local revenues are exceeding budgetary expectations and relief rolls are diminishing. The temptation is strong to expand government services and get rid of unpopular taxes. Sound public policy requires that both of these temptations be resisted. Public works not directly connected with defense, no matter how meritorious on general grounds, should be postponed until after the emergency has passed and we can once more afford to devote our men and materials to raising the standard of living of our citizens. I cannot agree with the superficially logical view that state and local taxes should be reduced in order to make it easier for taxpayers to bear the burden of increased federal taxes. It is natural for taxpayers to attempt to avoid a reduction in their standard of living, but taxes will not serve the essential purpose of helping to divert resources to defense production unless consumer expenditures are sharply reduced.

State and local government should decrease expenditures. They should not reduce existing tax rates and they should devote surplus revenue to the repayment of debt. This would be anti-inflationary, in harmony with governmental policy. In commenting upon the regulation recently issued by the Board of Governors to dampen

consumer instalment credit, I emphasized the importance of the repayment of debt by individuals:

> "When incomes are at high levels that is the time when people should reduce their debts or get out of debt. Our people cannot spend their increased incomes and go into debt for more and more things today without precipitating a price inflation that would recoil ruinously upon all of us . . . By deferring civilian demand at this time, we can help avoid inflation, we can aid in defense, and we can store up a backlog of buying power that will help offset a post-defense slump."

Repayment of debt by state and local governments is equally important at this time.

Looking ahead, however, to the post-defense period, the problems that we will then be facing will be the same in their essential nature as those that confronted us during the 30's and for which we succeeded in finding only a partial solution until the beginning of large-scale expenditures under the defense program. They are the problems of poverty in the midst of plenty; of the capacity to produce outrunning the power to purchase and consume; of millions of able-bodied and skilled workers without employment; of idle plants and factories. Yet, if we have the will, we know the way to meet those problems. We have before our eyes a conclusive demonstration of the way in which vigorous and determined action by government can transform a situation of general overabundance to a situation of general scarcity within the space of a few months.

The general problem of finding a market for the products of farms and mines and factories that is large enough and stable enough to provide steady employment for all who wish to work is one that confronts all the industrial countries of the modern world. In the United States this problem is complicated by the great size of our country and the diversity of our economic activities. In those parts of the country that were settled earliest, wealth has accumulated and from the very beginning of our economic history accumulated wealth in these areas has sought and found an outlet for investment in the development of the resources of the frontier regions that were one by one opened up to settlement. Year after year this process continued. The result has been a vast aggregation of obligations which the citizens of areas that offered opportunity for investment owed to citizens of areas that had capital seeking investment. These obligations took various forms: mortgages on urban residential and business properties and on farms, the securities, both stocks and bonds, of mines, public utilities, and other business enterprises, and the obligations of state and local governments. As the loans and investments grew, the volume of interest, dividends, rents and amortization payments also grew. Debt

payments had to be maintained both in times when prices for the produce of debtor areas were high and markets were large and in times when prices were low and markets were restricted.

In general, the creditor areas are also centers of manufacturing, that must look for a market not only to their own citizens but to the country as a whole. The maintenance of economic balance in the country as a whole requires that citizens of debtor areas have enough money income both to maintain interest, amortization and other payments on their obligations to investors in the creditor areas and to maintain at a high level their purchases of the output of the factories of the creditor areas. They must maintain their standing both as good credit risks and as good customers. This healthy state of national economic balance is continually being upset by forces that are entirely outside the control of the states or of the individual businessman and the individual worker. The result is recurrent periods of breakdown and distress, bankruptcy in debtor areas, idle factories in creditor areas and widespread unemployment and hardship in the country as a whole. There is no essential difference between this situation and that resulting from international debts. Both are, in essence, exchange problems. By tariffs, quotas, exchange restrictions, or even by resort to more punitive steps of a military or economic nature, including expropriation, nations attempt to redress the situation. The federal government alone can remedy this condition among the states—and taxation is one of the most effective means. Through that medium funds which the creditor areas drain out of debtor areas through interest, dividends and rents, as well as payments on debt, can be kept flowing back to sustain employment, to keep mines and factories in the debtor areas operating and continuing to yield returns to the creditor areas. I realize that the creditor states complain about paying more in taxes in proportion to what they get back from the federal government than do the debtor states. But that is a short-sighted attitude which fails to comprehend that in no other way can the debtor areas continue to yield returns to the creditor areas. I recognize also that the federal form of government does not adapt itself easily to a centralized and coordinated attack upon problems that must be dealt with as national problems if they are to be dealt with at all.

The problem of maintaining the standing of our citizens as both good credit risks and good customers is basically one of maintaining the national income at levels which represent the fullest possible utilization of our labor supply and other economic resources. Debts which can be easily carried and paid off when the national income is stable or steadily growing become insupportable when income falls. Defaults and bankruptcies used to be the accepted methods of dealing with these difficulties. But such methods are crude and unsatisfactory both in terms of economic values and human values. During the depression we developed better methods by attacking

the problem from both ends, by seeking to restore incomes and by adjusting debts of farmers and home owners through the Farm Credit Administration and the Home Owners' Loan Corporation.

In the future, the most important safeguard against the danger of a relapse into the intolerable conditions of the early 30's will be a long-run plan for public investment, adapted to the differing needs and conditions of our different geographical areas. So far as possible, this should take the form of productive public works and expenditures not only to improve the basic conditions which are responsible for keeping the standards of living in some of our states lower than in others, but also to raise the standard of living particularly in the lower income groups wherever they may be. Productive public investment, which should be noncompetitive with private enterprise, means not only roads, public buildings, subsidized housing, bridges, dams and irrigation projects; it also means better education and a higher level of public health and nutrition. The fact that so many of our young men called up for military service were shown on medical examination to be physically unfit is a shameful revelation of our neglect, as a democracy, to deal with national health and nutrition problems.

We will also need to extend and to make more uniform as between citizens living in different states the system of social security benefits. This mechanism is ideally suited to use as an anti-inflationary measure in times like the present and an anti-deflationary measure in periods such as we may have when the defense effort is over. This is the time to build up a reserve by increasing the taxes both for old age and unemployment, decreasing the taxes and drawing on the reserve as unemployment develops. And to insure that increased current revenues will be followed by an appropriate flow of outpayments when they are needed to combat the deflationary forces of the post-defense period, the old-age insurance system should be converted from its present contributory basis to a system that frankly recognizes and meets the national obligation to provide a minimum of support for *all* of our needy aged. We should give everyone reaching the age of 65 a minimum of $30 a month, regardless of the amount of his contribution to the system. Variations in payments to meet local conditions should be made possible by federal grants matching aditional payments made by the states up to $10 a month, thus enabling maximum payments of $50 a month. The federal government should recapture, by means of the income tax, payments of this type in excess of amounts needed by the aged to bring their total income up to a level representing a minimum standard of comfort. Such a revision would do away with the present complicated set of rules governing benefits; it would completely remove the cost of old-age pensions from the budgets of our less wealthy states; and it would make the support of the aged a national responsibility, as it should be. I also think it essential to

nationalize the unemployment insurance program extending the coverage to all workers and increasing the benefits both as to amount and time, increasing the rates and providing that employes contribute 50% of the tax and that it be uniform as to industries.

If we are to be succesful in the objective of creating a high and steadily increasing demand for the products of industry after the defense period, we must adopt a progressive tax system bearing heavily upon savings concentrated in creditor areas and lightly upon the great mass of families of the low income groups. This means that we must get rid of, or at least check the growth of the sort of taxes to which our states have unfortunately been forced to resort more and more in recent years. I am referring to the general sales taxes and the taxes on gasoline, tobacco, and other articles of mass consumption. These have taken on increasing importance in state tax structures in recent years as a consequence of the inadequacy of the general property tax and the pressure to find funds to finance relief and other welfare expenditures. Although these taxes were enacted with the commendable motive of preserving the solvency and credit standing of our state and local governments, they had an unfortunate effect upon the level of activity in the economy as a whole and were among the factors that made national recovery slow and incomplete until the beginning of the defense program. Their effectiveness as revenue producers is largely attributable to the fact that the federal government continued on a deficit basis throughout almost the whole of this period and thereby provided the stimulus for expansion of the consumer expenditures upon which these taxes were levied.

If we are to make progressive taxes the major element of our national tax structure, however, it will not be possible to continue the present system of having both the states and the federal government levy taxes on corporate and individual incomes and transfers at death. Increases in the rates of these taxes sufficient to make them contribute a major share of total governmental revenues over the long run would so intensify the existing difficulties that some change in the present chaotic system would be unavoidable. Citizens and corporations in some jurisdictions are lightly taxed because of a fixed policy in their states to compete for the domicile of corporations and persons of wealth. In other states they are heavily taxed because their states have taken the leadership in the use of progressive taxes. It has long been recognized that uniformity and equity can be attained only by making the total tax levied on income and on gifts and bequests a matter for federal control. This might be done along the lines suggested to you by Mayor La Guardia at your conference last year, by the device of allowing a limited tax credit against federal taxes for state taxes of similar type. We have already adopted this device for purposes of the federal estate tax and the federal unemployment compensation tax and we have seen that

it does give a powerful incentive to the several states to enact and collect a tax of a particular type, when they are led to do so by the knowledge that the revenue will go to the federal government unless they take appropriate action. However, while this device creates a presumption that a state will levy taxes only up to the amount of the federal tax credit allowed, it does not guarantee the taxpayer against the possibility that a state government hard pressed for revenue may not go considerably beyond this limit and it does not eliminate the possibility that the same income or the same transfer of property at death will be taxed by more than one state. In the end the only thoroughgoing cure for these difficutlies lies in a drastic reallocation of taxing powers between the states and the federal government. Such an allocation would involve restricting the right to levy taxes on income, gifts and bequests wholly to the federal government with redistribution of a share of the revenue from these sources to the states. I know how controversial this subject is but I think we will have to face, quite frankly, the implication that state revenues will tend to consist more and more of taxes shared with the federal government and of grants from the federal government, which already make up about 14 per cent of state revenues. The real question is how to retain the valuable elements of local initiative, local control over governmental services and adaptation of services to the differing needs and conditions of differing areas. We have had enough experience with federal grants and with federal direct expenditure programs during the depression to know that this problem is not insoluble. We should continue to follow the broad policy that has grown out of these activities of leaving responsibility for initiative as to the type of activity to be undertaken in the hands of state and local government, to leave, wherever possible, the detailed administration in their hands and to provide for federal supervision only to the extent necessary to insure that funds are wisely, prudently and honestly used. In a program of the magnitude and novelty that characterized federal spending for recovery, it is not surprising that there were mistakes but the failures as well as the successes of this period of experiment provide a valuable basis for the wise planning of the future.

I have outlined in a general way some of the main considerations that I think should apply in shaping taxation policy to the needs of the defense and post-defense periods. Let me add, however, that all I have said is based upon my profound conviction that we must make democracy function more effectively in the future than in the past—and that this can be done by democratic processes and methods, primarily by use of the government's broad functional powers of control. Fiscal and monetary action, properly used, can go far towards correcting the basic causes of economic breakdown. These over-all, functional powers—of which taxation is the most potent

single instrument—need to be supplemented by some direct controls at all times, particularly in a time like the present when we have acute shortages of strategic materials. However, the more wisely and effectively over-all controls are applied, the less will be the area in which there will be need for direct measures.

In the past, we have been slow, often too slow, to recognize changed conditions and to adapt our system to them. We have too often tolerated poverty while we failed to recognize that the proper function of the democratic system is dynamic, not static. Too often what we have thought of as our rights were wrongs for great numbers of our fellow citizens. We can—we must preserve our constitutional guarantees—freedom of enterprise and initiative, subject only to such limitations and restraints as are necessary to protect the public interest. But we must recognize that the right to work must be coupled with the opportunity to work. Freedom of speech, freedom to worship as we will, freedom of the press, all of our cherished liberties are of cold comfort to the destitute. There is no reason, except wilful blindness, why we cannot make our system function far better than it ever has before by guaranteeing that no willing, able-bodied worker shall lack for employment and that the aged shall not be in abject want.

I grow impatient—for events move swiftly in the world today—with those in your field and mine who say that fiscal and monetary policies suitable for the past are necessarily appropriate today. It is surprising how many who should know better, who should have learned from the experience of the past decade, still hold that taxation should be based exclusively on considerations of the need for raising revenue, without regard for the social and economic necessities that only the tax instrument can be adapted to meet, if intelligently used by government.

I recognize fully that in the day when we had a scarcity of capital, when new capital accumulations more or less automatically flowed into new production, it was wise public policy to have taxation contribute so far as possible to capital formation. All that we could amass at home and billions more that we borrowed from abroad went into the rapid expansion of the nation across the face of this continent. But I deny that in a day when capital is overabundant in relation to the outlets for its private investment it is still wise public policy to encourage its accumulation in stagnant pools. Rather I have favored during the decade of the 30's tax policies that tended to maintain the flow of purchasing power in the economy by forcing idle funds back into the circulation stream. That is a departure from the older orthodoxy, to be sure, but it involves no loss of fundamental liberties. It is no threat to democratic institutions. Rather, it is absolutely essential for their preservation. Similarly, I have favored the appropriate accompanying monetary policies. Thus during the depression, I favored making

the supply of money abundant and interest rates low in order to create an anti-deflationary climate which would be favorable for recovery provided positive action were taken at the same time in the fiscal field. By the same reasoning, I favor such anti-inflationary fiscal and monetary policies as are possible at this time, when the economy has moved rapidly towards full production and employment, under the stimulus of large defense expenditures.

In the day of capital scarcity, in the day when the gold standard prevailed for most of the world, even though it was never the unmanaged mechanism pictured by its most ardent champions, there may have been logic in relegating taxation to the role of revenue only, and in putting some reliance upon the interest rate as a regulator of economic excesses. But the late 20's disabused our minds of the notion that a high interest rate could curb speculation. The early 30's should have taught us that a negative fiscal policy was both economically and politically untenable. The later 30's should have demonstrated to us convincingly that a more positive policy, even though halting and hampered by widespread resistance, can have the most powerful effect in economic restoration. And the present period is giving us irrefutable proof of the degree to which a vastly expanded, positive policy called forth by national peril rather than by deliberate choice, can swiftly transform the economy from under-employment to boom conditions. Unhappily, the boom conditions are largely concentrated in the industrial sectors of the economy in the production of things of war instead of the things of peace that improve our standards of living. The logic of having taxation play a passive, neutral role in times past, and of having monetary policy responsive to international gold movements, rather than subject to national direction and control, is no longer valid in the world of today. Rather, the respective spheres of fiscal and monetary policy are reversed. Fiscal policy has assumed the greatest importance as a democratic instrument of economic action, while monetary policy assumes a secondary place. Both must be coordinated by deliberate action.

Even a cursory review of the economic history of the last dozen years indicates not only that democratic nations must and can without sacrifice of any fundamental principles use the functional Government controls of fiscal and monetary action, but that no other rational choice is open to those who profess to be in favor of preserving our institutions. The question is no longer whether such functional powers should be turned deliberately to helping us solve our economic problems, but whether we can so organize and coordinate our democratic processes, that the necessary flexibility and administrative discretion will be afforded to achieve the best results. I am aware of the difficulties. They are inherent in established legislative processes, and the division of powers. They are present,

particularly, in the relationship between the federal government and the states.

We have not made much progress towards simplification so far, but the time has come when we can no longer continue to tolerate this chaos. For the fact is that with the increasing assumption by modern governments of social and economic responsibilities, in the light of the increasingly important role that governments play in affecting economic conditions, what may have been an endurable conflict in the highly important fields of taxation is now too serious, too much of a limitation upon necessary democratic action, to ignore.

It is not necessary, before this audience, to stress the point that there can be no consistency or continuity of national economic policy, it can have no adequate flexibility, if it must be exercised in conflict rather than in harmony with the states. Manifestly if the federal government is to be effective in using its powers to dampen inflationary tendencies, state policies must, on the whole, be aimed in the same direction. In the post-defense era, federal action to offset a slump will be ineffective to the extent that the states are not prepared to act in concert with government policy.

In brief, montetary policy should be the servant, not the master, in the economy. We should rely heavily upon fiscal policy, its timing and application, as a stabilizing factor and as a motivating force without which monetary policy alone is ineffective. We should utilize and coordinate these over-all instruments of public policy, not only because of their demonstrated effectiveness, but because they are the only logical alternatives to a no longer possible laissez faire, on the one hand, and a regimented, policed economy, of fascist character, on the other. There is no reason why we cannot learn to use them more intelligently in the future than we have in the past, recognizing always that these and other functional controls are at best supplemental to the main driving force of private enterprise. There is no reason why democratic processes cannot be adapted, and every reason why they should be adapted to using these instruments of economic influence to the fullest, not only in the defense period but in the future when the economic problems of a world at peace will ironically be even more difficult to deal with than the economic problems of a world at war.

Chairman Coffey: Just a moment, please. Mr. Long, of Massachusetts, will present a matter now.

Henry F. Long (Massachusetts): Mr. President, I wish to offer this resolution:

> Whereas, in 1926 the National Tax Association appointed a committee to confer with the American Bankers Association on the amendment of Section 5219 of the United States Revised Statutes (providing for the state taxation of national banks)

authorizing the "fourth" alternative method which was duly enacted by Congress, and

WHEREAS, the American Bankers Association in its recent reply to the United States Senate Banking and Currency Committee questionnaire (dealing with national monetary and banking policy) has indicated the desirability of clarifying the "fourth" alternative method in that section provided, and also recommending authorizing the application of state sales and use taxes on national banks, and

WHEREAS, constructive changes have been made in state taxing systems since the last amendment of Section 5219 in 1926, such as the adoption of sales and use taxes by many states and minimum taxes on state banks in taxation measured by net income from all sources by some states; therefore be, and it is,

RESOLVED, that the Thirty-Fourth Annual Conference on Taxation sponsored by the National Tax Association authorize the president of the association to appoint a committee of five (two of whom shall be chosen among the past presidents of the Association) to confer with an authorized committee of the American Bankers Association for the consideration of the amendment of Section 5219 as herein indicated.

Mr. Chairman, I assume in accordance with the rules, that that will be referred to the Committee on Resolutions.

PRESIDENT MAXWELL: That is in accordance with the rules of the conference.

I am just taking the microphone to make one announcement about the Committee on Nomination of Officers to the Tax Association. It is provided that that committee is constituted in the main of ex-presidents of the National Tax Association. Each ex-president at this conference is a member of the committee. In addition to that, the president is to appoint three additional members, and I wish to announce the appointment of Senator Orr of Minnesota, Mr. Saxe, of New York, and Mr. Stevens, of California, as the three additional members of that committee, and to request that the committee have at least an initial meeting in Room 1100 at the Lowry Hotel, I will say at 6 o'clock this evening.

I am sure we are all very much indebted to President Coffey and others of the University of Minnesota, including our good friend who arranged this program for us, for arranging this delightful session here, and to this distinguished gentleman, Mr. Eccles, for the very able address he has brought to us.

Are there any further announcements?

The meeting is dismissed.

(The meeting thereupon adjourned, at 2:40 o'clock.)

TENTH SESSION

TUESDAY, OCTOBER 14, 3:00 P. M.

Museum of Natural History Auditorium
University of Minnesota

Lovell H. Parker, presiding.

CHAIRMAN PARKER: I think we might as well start the session, ladies and gentlemen. We are a little bit late, and I think we had better let the speakers—we have four speakers, all of whom are very well worth listening to—conclude before we have any general discussion, because the time is very limited.

As for myself, I have nothing very much to say on taxation, except that I think our present system is a matter of compromise between two poles, we might say,—the north pole and the south pole. Some people would like to tax everybody 10 percent of what they make, on the income tax. Well, that is the old Bible system, tithes. The other extreme would be to take 100 percent away from everybody that made more than $1,300.

So now you have to get in between there somewhere, and just what the right answer is I think probably the speakers this afternoon will throw some light on.

It gives me great pleasure to introduce as the first speaker the Director of Tax Research of the United States Treasury Department. I have had the opportunity of knowing the director for a number of years, and I have seen him at work. I know how highly he is regarded in the Treasury, and on the Hill, as we call it, and he has at his disposal probably more accurate facts dealing with taxation than anyone else. I know you will be interested in what he has to say, and you can depend upon the accuracy of his facts.

It gives me great pleasure, ladies and gentlemen, to introduce Dr. Roy Blough, of the United States Treasury Department.

THE FEDERAL PERSONAL INCOME TAX UNDER THE REVENUE ACT OF 1941

ROY BLOUGH

Director of Tax Research, U. S. Treasury Department

The federal personal income tax as revised by the Revenue Act of 1941 is expected to produce $3,400,000,000 in a full year of operation.[1] This represents an increase of $1,145,000,000, or 52 percent,

[1] Estimate based on the levels of income estimated for calendar year 1941.

over the comparable estimated tax yield under the preceding law which already was far higher than the actual collections thus far in any fiscal year in the country's history.

The national emergency requires unprecedented increases in governmental revenues and it is essential that the personal income tax should be relied upon for a large proportion of these increases. The income tax is a true personal tax. In so far as may now be practicable, it takes into account individual differences in taxpaying ability, as reflected in the size of personal incomes. It also takes into account, although to a less adequate degree, differences in the size of personal obligations and responsibilities. In these respects, the personal income tax is far superior to other forms of taxation and constitutes a logical source for a large part of the revenues currently required by the government.

The Revenue Act of 1941 made several important changes in the personal income tax. The personal exemption of single persons was reduced from $800 to $750. The exemption for married couples and heads of family was reduced from $2,000 to $1,500. These are the lowest exemptions in the history of the income tax. For married couples, they represent a 40 percent reduction in the personal exemption effective as recently as 1939. In revising the personal exemptions the act this year departed from the practice of allowing married couples 25 percent more exemption than two single individuals and made the exemption of married couples exactly twice that of single persons. The $400 credit for dependents remains unchanged.

Formerly, an individual who acquired the status of head of family because of more or more dependents was entitled to both the head of family exemption and the credit for each of the dependents. The 1941 Act disallows the taxpayer the credit for that dependent who secured for him the head of family exemption.

The surtax rates were greatly increased, and adjusted further to absorb the 10 percent defense tax imposed by the 1940 Revenue Act. The normal tax, nominally left unchanged, was in effect reduced from 4.4 percent to its previous level of 4 percent.

The surtax is now imposed on all income above the personal exemption and credit for dependents and ranges from a rate of 6 percent on the first $2,000 to 77 percent on the amount exceeding $5,000,000. Heretofore, a substantial amount of income in excess of the personal exemption and credit for dependents was not subject to the surtax. This amount varied from a maximum of $20,000 under the Revenue Acts of 1913 and 1916 to a minimum of $4,000 under the 1934 and later revenue acts. The decision to raise the surtax rather than the normal tax was affected by the existence of a substantial volume of partially tax-exempt Federal bonds. An increase in the normal tax would increase the tax-savings accruing to the holders of such bonds. To reach the lower levels of income,

without granting a bonus to holders of partially tax-exempt securities, the tax increases were imposed in the form of surtaxes; the normal tax was left unchanged.

Because the surtaxes begin with the first dollar of income above personal exemptions and credits for dependents, a very substantial number of people not subject to normal tax will be subject to surtax. This is due to the operation of the earned income credit, which was left unchanged. Since its reintroduction in 1934 the earned income credit has been a credit against net income amounting to 10 percent of earned net income (but not in excess of 10 percent of net income) with all net income under $3,000 being considered earned and all net income over $14,000 being considered not earned. The earned income credit was and is allowed only in the computation of the normal tax. In consequence, a married couple with income of not more than $1,667 is liable for surtax on the amount above $1,500 but is not liable for any normal tax.

The value of the earned income credit in dollars of tax saved has not increased, the normal rate having remained at 4 percent. With successive increases in surtax rates the earned income credit has become less and less important in relation to the total tax.

These rate changes and extensions, especially when added to those of the last two years, substantially alter the character of the income tax. It is expected that under the Revenue Act of 1941, 22,000,000 persons will file income tax returns; that 13,200,000 will be taxable. This means that nearly half the families and single persons in the United States will file income tax returns and that about 30 percent will actually pay some income tax. Before the Public Salary Tax Act of 1939, the number of income taxpayers was seldom more than 3,000,000 persons; the number for 1937 was 3,370,000. The extension of the income tax to public salaries, the reduction of the personal exemptions, and the extension of the surtax rates down to the first dollar of taxable income, together with increases in income and employment, have been responsible for these changes.

The extension of the income tax to many millions of additional persons has focused attention on the need to simplify the task of taxpayer's compliance. Persons with small incomes derived from simple sources cannot be expected to have much familiarity with accounting methods and tax schedules. In recognition of this, the Secretary of the Treasury proposed and the Congress has adopted an optional simplified tax form for those with incomes of $3,000 or less derived from salaries, wages, interest, dividends, and rent. The optional tax form eliminates all schedules and retains only enough lines to record the income from wages and salaries, from other sources, total income, and personal exemption and credit for dependents. It dispenses with the necessity of the taxpayer computing his tax base, there being no need for computing deductions or earned

income credit. The return groups incomes in $25 size intervals and imposes the same amount of tax on every income in that size group. The taxpayer needs only to write his income on the face of the return, turn the leaf over and locate his income on the back. His tax is the amount shown opposite the block of income in which his actual income is located.

The taxes imposed by law for persons using the optional return were computed under the regular rates, and then diminished by 10 percent in order to allow for deductions such as taxes paid, interest paid, and contributions. Doubtless this 10 percent reduction allows some taxpayers more and others less than they would receive in deductions otherwise. However, the form is optional and should not result in serious injustice, except in so far as the Treasury will receive somewhat less tax because of it. It may be anticipated that there will be a good deal of petty tax counseling by persons offering to help those with low incomes and substantial deductions to fill out the regular income tax form and save money. This is the counterpart of the efforts of tax lawyers and accountants to reduce the income taxes of their clients.

The simplified tax return represents a promising departure from complex tax forms about which complaints were often heard. It is made possible by the fact that the patterns of income to which it is confined are simple. Complicated incomes require complicated laws and complicated returns if the income tax is to be equitable. This fact should not discourage efforts to simplify the computation of the tax where the income is simple.

Several less important changes remain to be mentioned. The withholding tax was raised to 27½ percent, with the regular income tax applied on amounts withheld in excess of $23,000. To accord with the reduced personal exemptions, compensatory changes were made in the filing requirements.

In prior years, information at source was not required in the case of interest paid on bonds issued by the Federal Government. In view of the Public Debt Act of 1941, making the interest on all future issues of Federal bonds subject to income tax, the provisions relating to information returns were made applicable to the interest paid on all Federal obligations.

One other provision of the 1941 Revenue Act bears mention. In the case of non-interest bearing securities sold at a discount and redeemable for fixed amounts at stated intervals, a taxpayer may elect to include the increase in redemption value occurring during the year in computing his net income. Under prior law, the entire increase in redemption would have to be returned in the year in which the bond matures.

The new low-income taxpayers will contribute a relatively small proportion to federal revenues. The proportion of the total tax yield

coming from persons between $3,000 and $10,000 has been substantially increased.

The extent of the changes in effective rates under the 1941 act is shown for selected income brackets in the following table.

(For married persons with no dependents)

Net income before exemption	Effective rate		Percentage increase in tax	Increase in tax as a percent of amount remaining after tax under the 1940 Act
	1940 Act	1941 Act		
2,500	0.4%	3.6%	718.0%	3.2%
3,000	1.0	4.6	345.2	3.6
5,000	2.2	7.5	240.9	5.4
10,000	5.3	13.1	147.2	8.2
50,000	28.3	40.9	44.7	17.6
100,000	43.5	52.7	21.2	16.3

In the nearly five months that the Revenue Bill of 1941 was receiving Congressional consideration many changes were urged upon the committees and considered by them but not adopted. Certain of these changes were deliberately put aside for later consideration in the expected administrative or technical bill. Others will undoubtedly come up again during consideration of the next regular tax bill. Only a few of many interesting items can be discussed in the available time.

Perhaps the most controversial proposals concerned the related matters of community income and mandatory joint returns. The provision for compulsory joint returns was inserted in the bill by the Ways and Means Committee. A vigorous public reaction followed, revealing some of the strangest bed fellows in tax history. After a debate which is well worth reading, mandatory joint returns were rejected by the House. The Senate Finance Committee inserted a provision to tax community income in the so-called community property states to the spouse having management and control. In the face of the vigorous opposition of Senators from the community property states, who objected to " hasty " action without public hearings, this provision was withdrawn on the floor of the Senate and the whole matter, which has been considered off and on since 1921, was put over for the administrative bill.

Consideration of tax-exempt securities was deliberately passed over in the bill. Exemption of interest from subsequent issues of federal securities was abolished by legislation passed early in 1941. With representatives of state and local governments still vigorously opposing the same action for interest from state and local securities

because of the benefits of slightly lower interest rates which the exemption combined with high federal tax rates affords them, a not inconsiderable controversy would have developed if the matter had been considered. The matter can hardly be postponed much longer since every increase in the tax rate magnifies the injustice. Recent reports in the commercial press that individuals in the higher brackets are moving more and more into tax-exempts makes the matter of increased importance.

Another feature which the Revenue Act of 1941 does not contain but which some people urged upon the committee is collection at source through withholding the tax on income payments such as wages and salaries, interest, dividends and rents. Much can be said in favor of that suggestion. The collection of a heavy tax in installments makes the burden more easily bearable. It is not as keenly felt when the taxpayer never sees the money. Of importance, also, is the significance of the income tax for purposes of price control. The broadening of the income tax and the rate increases assist in retarding price inflation by removing purchasing power from consumers. The potentialities of the income tax in this respect can be greatly augmented by speeding payment of the tax. At present, the time which elapses between the receipt of income by the individual and the final payment of the tax ranges from several months to almost two years. The delay in transferring purchasing power from the hands of consumers has the effect of temporarily augmenting that purchasing power, in the sense that the taxpayer has the use of funds for which tax liability has been incurred. By removing the tax from the income stream as the income is earned, the consumer is prevented from employing the amount of the tax to bid up the price of a limited quantity of goods. It should be noted that the tax-at-source device can be effective in retarding inflationary influences only if it is applied with respect to the tax on income earned currently as distinguished from the tax on the income of the previous year.

Under American conditions, a plan for the collection of tax at source presents great complications. Such a plan was in operation in the United States in the early years of the income tax but was quickly abandoned. The foreign experience to which reference is commonly made has for the most part been the collection at source of tax on last year's income, not the tax on this year's income. Problems of personal exemption, deductions, and credit are difficult to solve. Such a tax could in any event apply only to the flat rate normal tax and minimum rate surtax and not to a progressive rate surtax. It is certainly not beyond probability that heavier taxes on low incomes will make collection at source desirable despite the difficulties. Moreover, the difficulties themselves may be resolved with further study.

Some persons appearing before the committees advocated the adoption of a gross income tax without personal exemptions or other deductions. This is analogous to the payroll tax now imposed on wages in covered employment under the social security insurance programs. Such a tax might be a logical form of taxation not only for social insurance, but also if it were desired to build up a credit for individuals, either for severance wages or for some form of compulsory savings to be returned later. However, to impose a regular tax for general revenue on gross income without deductions, as part of the income tax or as a substitute for part of the income tax, would violate the basic principle of income taxation. The virtue of the income tax is its ability to distinguish between persons in different economic conditions, between persons whose incomes barely support life and those whose incomes leave large surpluses for savings or comforts and luxuries. To abandon these distinctions with respect to a large proportion of the population through eliminating the personal exemption, credit for dependents and all deductions is to destroy the basic principle for which the income tax stands. The issue must not be confused by reference to frequent installment payments collected at source. Such forms of payment reduce the financial inconveniences of tax payment, an objective which is highly desirable, but they no basic relations to the principle of ability to pay, which rests on much broader factors than mere time of payment. Furthermore, collection at source or frequent in-installment collection is possible, even though subject to some administrative difficulty, with a genuine net income tax.

The personal income tax is a potent and elastic method for securing revenue and its impact can be adjusted and readjusted to meet considerations of equity. It has gone far in a quarter of a century. It is still in the process of development. It is worthy of our most devoted study and effort to make it more equitable and more productive to the end that it may become and remain the dominant fiscal instrument it deserves to be.

CHAIRMAN PARKER: I know you have all enjoyed hearing Dr. Blough, and I thank him on behalf of the session and on behalf of myself.

We will take the program out of order. The next speaker has to leave on a train, and I will introduce Dr. William Paton, Professor of Accounting at the University of Michigan. I think most of you know him, either personally or through his writings, and I want to simply say that our income tax would be much better if it could follow more closely sound accounting principles.

WILLIAM A. PATON: I don't want to butt in here and take up the time of other more competent speakers, but I assure you I won't be very long, at any rate. I ought to say, in the first place, that I cer-

tainly am no income tax expert, and hence am perhaps a rather poor choice to speak on the subject, with particular reference to an accounting point of view.

Time was when I might perhaps have qualified. I did work in the income tax unit back in 1919, which is some little stretch behind us, and for quite a number of years following that contact, kept in very close touch with the technicalities of law, but partly through the development of a sort of sour attitude toward the whole thing, I have let my attention to the technical details wane to such a point that I certainly can't speak here as a technical accounting expert on income taxes.

I am not going to make any effort to discuss special features of the immediate legislation, but take what time I have to call atten--tion to certain rather broad critical attitudes that practicing accountants have developed with respect to income tax structure and perhaps these attitudes have no practicality in them; but nevertheless I am going to air my views briefly with respect to these general considerations.

Away back in 1920 or thereabouts, I wrote a little sketch for one of the national tax magazines, entitled, "A Simplification of the Federal Tax Structure," or by some similar caption, and, needless to say, I didn't make any impression.

But the fact remains that accountants generally adopt an attitude which may surprise some of you. We feel very critically inclined to what we consider to be the undue complexity of the federal income tax structure. The preceding speaker, Dr. Blough, referred to this point, but I am going to labor it just a little. Perhaps it is a common failing of human institutions that they tend to tyrannize over us as they develop, but, at any rate, I doubt if anyone in the early days of the income tax, modern income tax program, had the faintest notion of what an incubus the thing would finally become on the purely technical side.

I realize that a great deal of this over-elaboration of complications has had as its root the idea of achieving a greater degree of equity, and, in that sense, it is more or less commendable. Some of it I think has had as its root the zealousness of people to explore various types of financial form, redistribution of wealth, and so forth, through the medium of income tax structure.

Taking issue with Mr. Eccles flatly on that, I consider that, in general, that is a rather baneful influence to have prominent in the development of federal income tax legislation and administration.

With respect to the equity angle of the case, I have thought for a long time that often you can achieve more equity with a meat-ax than with a scalpel. That is, it is quite possible to introduce refinement on refinement, well intentioned in the first place, intended to promote justice, equity, with respect to groups and parties in particular types of situations, but I just raise the question here as to

whether a somewhat rougher and more primitive carving out of structure might not actually achieve greater equity than we have been able to with all these complications.

On balance, I would be able to say this: that each successive piece of legislation we have had has been a more complex structure. Certainly there has to be a limit to that sort of thing sometime, or who in the world is going to raise the potatoes? We can't very well have nothing but tax experts. All human time and energy cannot be expended in making out tax returns and other governmental forms. So, sooner or later, it would seem as if a halt might well be called on the continual elaboration and adding of complications.

Perhaps it seems funny for an accountant to say something of that kind; but even an accountant can get tired of complication. Even an accountant sometimes longs for a little time and energy to spend on something possibly slightly more constructive than working on income tax returns. And I don't think that the average of accountants can fairly be referred to Dr. Blough, as simply making an effort to reduce taxes. I know quite a few accountants who are concentrating their efforts primarily to see to it that their clients are reasonably treated under the law. If I had time to elaborate that, I would tell you some more of the stories which I told some of you down in Washington a while back. I have collected a lot of choice ones since, that are well authenticated.

To be a little more specific, let me just mention a few of the complications in our structure, many of which are of long standing. The earned income credit, the wash sales provision, the sorting out of capital gains and losses as if they were something very special, and treating them in a flock of different ways through the years, percentage depletion, involuntary conversion, discovery value, inadmissible assets, improper communication of surplus, accumulation of surplus—oh, my! And then this continual elaboration of alternatives. You have a chance to do it this way, but here is another scheme under the law which you might conceivably tackle. Just think for a moment of one specific feature—this business of permitting a corporation a credit of 85 percent of dividends received from the domestic corporation itself subject to the tax, and then, of course, there are some strings tied to that, even that 85 percent.

If there is any sense in that, at all, of course, the 100 percent should be a credit, just as it used to be. What virtue is there in 85 percent? It is a good deal like slapping a fellow across the face, and then handing him a handkerchief to wipe the tears out of his eyes.

I feel that present in a whole lot of that is misguided desire for equity, misguided desire for reform, and, above all, a desire to kick the corporation in the slats.

My main golden text here is simply this general suggestion: I think the fundamental weakness in our income tax structure from

the standpoint of complication and equity is, first, the effort to treat the corporation and the natural person as simultaneously income-producing entities, and then, second, the everlasting effort to lambast the corporate structure at every possible point. There are a tremendous number of people in this country, including a lot of our legislators, who feel convinced that there is something pernicious, something nefarious about the corporate form of organization; the corporate structure, just like the income tax structure, may run away with us.

As I said a moment ago, human beings have that interesting quality of being able to create institutions for their own benefit that very shortly get out of hand—government, for example.

But it would seem to me that people who know most about the situation would be inclined to agree that the corporate form of doing business is not in itself a baneful or unreasonable thing. It is closely related to and parallels the technological development, and I would be inclined to submit that you can't feed a great city like Minneapolis without the corporation, the corporate form of handling affairs, perhaps, any easier than you could feed it without the railroads or some of the technical things. Anybody who will look at this with any objectivity, I think, will see that our tax structure has become increasingly complicated all through the years of this attempt which I have crudely put as kicking the corporation in the slats. A tremendous mass of our technical complications arises out of dealing with these two entities, the natural person and the corporate institution as parallel taxable entities.

I don't suppose there is the faintest likelihood of any change for some time in this situation. If you want to get a good hand-clap from your colleagues in the federal Congress or in the state legislature, just get up and start cussing the corporation. You can always get a cheer. A lot of very well-meaning people all through our life immediately distinguish between the attitude in which government should deal with matters of taxation or anything else with the corporate form of organization, as for instance, compared with a partnership. Of course, what I would like to see done—I would like to see us moved toward a rather revolutionary attack on the existing structure in that connection. I would like to see us experiment vigorously, more vigorously than we are—there are a few touches of it at the present time—with taxation of individuals on their distributive shares, in corporate earnings, with corporate earnings computed without too much fussing in accordance with what might be called ordinary mine-run accounting procedure.

I don't think a corporation is a fit vehicle for the income tax. If we desire to levy a small tax of 5 percent or so on corporate incomes as one method of making a franchise charge for that type of doing business, no one could offer any serious objection. But just compare our income tax structure from 1913 right down to the present,

and see what has been happening to corporate taxes. That whole matter interests me, not because I have got any great brief for the soulless corporation, as such, but because it seems to me it relates to wholesome, energetic business activity, and, in the long run, equity between individuals.

The undistributed profits tax is not, to my way of thinking, a proper way of going at it, but a tax on distributive shares, a tax under the association theory of the corporation, as opposed to the equity theory, has a lot of merit on paper. Most people are inclined to shy away from it, in the first place, on the ground that it is too revolutionary, and there probably wouldn't be any chance of putting it through, which I am inclined to agree with, but also on the ground of complexity.

I haven't time to elaborate this, but I do feel that that is something I have given some very considerable thought to, and know a little something about, and I don't believe it would be an added complexity on balance. I think if we went over wholeheartedly to some such approach, this appalling mass of technicalities would be greatly reduced.

Of course there would have to be some integration of the corporate fiscal policy with the fiscal policy of the individual. For one thing, it might not be altogether unwholesome for the stockholder to have a little more intimate grip on the question of the administration of income, to have a little more power with respect to the administration of income. The way to solve that isn't to shove that authority down to Washington and put on a punitive kind of undistributed profits tax which compels the corporation pay income out as dividends, whether the corporation would otherwise desire to do so or not, but a tax on distributive shares, just as in the case of the partnership, would put it up squarely to the particular corporation and its stockholders to consider seriously integration of their desires and their needs.

One of the things that might be done in that connection would be to take it or leave the dividend. In other words, dividend declarations might be declared, might be made in cases in which there is doubt about how the thing should be handled, with the understanding that the stockholder may draw his dividend or leave it with the company in accordance with his own desires and fiscal needs.

Well, I haven't time to elaborate the thing. I have already used up quite a share of my twenty minutes. But I feel that we are not likely to get very far in the improvement of the technical structure, the simplification of the technical structure and the reduction of the appalling amount of time and energy that is being devoted to the administration of income tax along the present line.

I also feel very strongly that to put successive serious complex penalties one after another, add them one after another, into an income tax structure, designed to make the corporate form of busi-

ness organization successively less attractive as a vehicle for doing business, is very unfortunate.

I haven't time to go into the very considerable subject, but certainly I can dwell on another phase of this thing that accountants are very much interested in, and that is the flavor of the administration of the corporate and personal income tax structure such as it is at the present time. Accountants and taxpayers may be wrong, but I am giving it to you straight from the shoulder when I say that they almost unanimously believe that they are being dealt with with increasing unfairness and lack of good faith. I see some of you know what I am talking about, at any rate.

That, folks, is a serious situation, because, in particular, the fact that a tremendous amount of time and energy, an increasing amount of time and energy, is expended fighting these matters under conditions of that kind. Of course, the Treasury folks will tell you—Mr. Blough will tell you—"Why in the devil don't you taxpayers tell us about these crooked practices, this blackmail, and so forth, that is being indulged in from one end of the country to the other? Why don't they make specific complaint?" I can tell you why—they are fearful of reprisal, and they haven't any confidence in the higher-ups to protect them.

I don't know that there is anything in particular we can do about it, but I believe that it is at least within our rights as citizens for us to express ourselves on the reaction of taxpayers and accountants who have intimately to do with these affairs when we see the opportunity. It is particularly reasonable, perhaps, for me to take a chance, when I am not primarily in tax practice, although even a professor may get so he would have to watch his step.

There was an FBI man in my office not long ago, and the last thing he said to me, just as he left, was, "Well, I will see you in concentration camp, Mr. Paton." That is a direct quotation. Of course, he was sort of laughing as he said it, but the thought was flowing through his mind that "maybe here is a fellow just as well off if he was behind the barbed wire."

Human nature is a great deal the same wherever you find it, amongst labor unions, amongst business men, amongst internal revenue agents, amongst taxpayers and their advisers. It is one of the most important things in the field of taxation or anywhere else, to get over this idea of imputing all the virtues to one group, and all the evil to the other group. It is entirely unreasonable. It is most unfortunate, to say the least, that through the last twenty years, and particularly the last ten, there has been a growing attitude on the part of public accountants and their clients, that there is increasing unfairness and increasing lack of good faith. Here is a concern that will spend $5,000 or $10,000 developing its plant account apparently in accord with the recommendations of the internal revenue office, revising the returns, and in what seems to be perfectly good

faith, going ahead and trying to cooperate. A year or so later, a young whippersnapper blows in and says, "That is no good. You are completely off the track. I am going to put on some additional assessments." That craze for the additional assessment! What it means is greater resistance on the part of the taxpayer. I don't think it means collecting more money at lower cost per dollar, in the long run. I don't think it even works out on the fiscal side. I think it is going to mean collecting less money per dollar of effort expended, in the long run.

Taxpayers who would not have thought of such a thing years ago are now putting what we call sleepers in their tax returns. These folks here have heard of that. A good deal like the situation of a contractor who was building roads for the State of Michigan, and he found that they always made him tear up a mile or two, or do something like that—so he got onto it, shortly, and began to leave a mile or two in bad shape. When the inspector came along and struck that, and got his note book and told him where to head in, the contractor went ahead and did it just like he expected.

I know this to be a fact: I believe there are thousands of cases, and I know there are some, where taxpayers are deliberately throwing in jokers in their tax returns for these fellows to find, because they know if they try to play fair, the chap is going to make his assessment, anyhow.

I heard one man say this; he said, "Well, of course, you are right. That is from an accounting standpoint—from the standpoint of law. But I am going to put the assessment on, just the same."

Now see what you can do about it.

Thank you.

Chairman Parker: I don't think after the applause, I need to thank Mr. Paton. I think he gets his thanks, all right.

Our next speaker—it is getting late; we have to rush along—is Dr. Harley L. Lutz, of Princeton University, Professor of Public Finance. He needs no introduction to you. He was president of the National Tax Association from 1927 to 1928, and his valuable contributions to tax legislation must have come to your attention.

Dr. Lutz.

Harley L. Lutz: Mr. Chairman, Ladies and Gentlemen:

I think it is very fortunate indeed that Professor Paton preceded me. It gives me a very good springboard for some of the things that I want to say.

I have a very long paper, and I can assure you that I am not going to read all of it. I shall endeavor, in summarizing, to bring out simply some of the principal points that were in my mind in writing it.

SOME ERRORS AND FALLACIES OF TAXATION AS EXEMPLIFIED BY THE FEDERAL INCOME TAX

HARLEY L. LUTZ
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Federal taxation of incomes, made legally possible by the 16th Amendment, had long been the dream of tax reformers. The system of taxation that has developed under this amendment is today regarded, by many, as perfection in a world of imperfect taxes. To criticize it, except in the most friendly and favorable way, is to lay profane hands on the Ark of the Covenant. The general attitude toward it resembles that of the doting relative toward the spoiled child—its obvious and glaring defects are for the most part unseen, and when they cannot be ignored, they are glibly explained away or glossed over.

This paper deals with some issues of definition and policy. Despite spasmodic efforts at simplification, the text of the law remains complex and confused. The most frightful example of obscure, complicated verbiage yet produced was the original sub-committee draft of the Second Revenue Act of 1940. In no small degree this complexity and confusion may be attributed to the general misunderstanding of some of the broad issues involved.

I

THE DEFINITION OF INCOME

The 16th Amendment uses the word "income" without defining it. Obviously, under this amendment, legislation providing for the taxation of incomes could proceed in more than one direction. It has been assumed, however, from the beginning, that the only proper way of applying the 16th Amendment is to levy upon some vague, but emotionally satisfactory tax base called net income. The statutory meaning of this term can be ascertained only indirectly, as the difference between two sets of items of receipts and deductions, respectively, both of which are arbitrarily prescribed in the law. A tangled jungle of verbiage—statutes, regulations and rulings, opinions and decisions—has been produced by the steady accretion of words in the process of elaborating, or limiting, the supposed meaning of these items.[1]

[1] Senator Clark of Missouri recently said:

"I defy anyone in this Chamber who is not a member of the Committee on Finance, or, in fact, anyone in this Chamber who is a member of the Committee on Finance, or anyone outside of this Chamber who is not a tax attorney, just to take this bill and run right through it and tell what everything in it means. We cannot even consider one

Although the design has been to tax something called net income, this objective has not always been achieved.

(1) With respect to corporation income, no adequate distinction is recognized between profit and net income. The law uses the words profits and income as synonymous and interchangeable. Yet in the economic sense they are not the same. The concept of business profit refers to the result of operations for a certain accounting period, such as a fiscal year. Net income is that final result of economic production which can be taken out of the productive process without impairing the capacity of the productive factors to produce more income.

At best, profit is only an approximation of net income. It is not conclusive evidence that income has been produced. There may have been, in prior years, business net losses or some other impairment of capital. The first obligation for the disposition of profit is to offset these losses. Only after that has been done in full, regardless of the time required, can there be said to be a net income from the business operation. The history of the net loss deduction in the federal law reveals, at most, only a grudging recognition of its importance, and no conception of its significance as a factor indicating the gap between profits and income. The failure to allow in full for prior net losses or other capital impairment means that the tax is often levied on capital rather than income.

(2) Even with this important modification, net income is necessarily a business concept. It involves and implies an establishment consisting of the various factors of production, managed and operated to the specific end of producing income. In income taxation there has been a general tendency to transfer this purely business concept to the realm of the individual, and in consequence we speak as glibly of individual or personal net income as we do of business net income.

Actually, there is no such thing as personal net income, except in an extremely arbitrary and artificial sense. If this concept is to be validly applied to the individual, we must think of him as an income-producing machine. In other words, we must think of him, not as a person for the satisfaction of whose wants the whole complex of production exists, but as a small-scale business unit. From this point of view the individual who receives income as a reward for his productive services should be allowed to deduct all of the costs of getting

of these bills without the aid of about 45 or 50 experts, experts from the Treasury Department, experts from the Internal Revenue, experts from the joint Tax Committee. None of us can take one of these bills and tell what it means, because it is a patchwork system. . . . Every tax bill which comes before us amends this or that, and we cannot understand it without going back and reading about 15 statutes and 45 Supreme Court decisions."

Congressional Record, Vol. 87, No. 161, 77th Cong., 1st Sess., September 4, 1941, p. 7459.

that income which would be allowable to a business unit of the recognized types. Only the residue after these costs had been met would be his personal net income.

This, obviously, is not done in any income tax law. The individual may deduct from his gross income any item which is analogous with, or similar to certain recognized business costs. Such deductible items include interest on debt, clerical help, property taxes, losses on bad debts, the expense of a motor vehicle used in getting the income, and so on.

But these and similar items of expense which are clearly analogous with business costs are not the whole story of the costs of getting an individual income. In lieu of the remainder, each person is allowed to deduct, as a personal credit, an amount which varies only according to marital status, and an additional small amount for dependents under certain conditions.

The theory upon which the flat personal credit is based is not, strictly, an attempt to provide a lump-sum offset to all unspecified costs of getting an income. Rather, it is a vaguely sentimental concession to the 19th century theories regarding an exempt subsistence minimum. The history of this item in the federal law reveals that the amount allowed has been determined purely on grounds of political and fiscal expediency. The amount allowed is the same regardless of the size of the income or of the actual costs of getting it. Reduction of this allowance is always the first move proposed to increase the revenues.

When the deeper parallel between the ordinary business unit which exists to produce income and the individual as a one-man or single cell income-producing unit is considered, it is found that the latter must incur many costs of getting income which he is not allowed to deduct, although the same, or the analogous costs, are deductible for the business firm. For example: [2]

The recognized business unit may deduct fuel and energy costs. The worker's food and recreation costs are his parallel to the fuel used by the factory. He must eat in order to work, and he must work in order to produce income. Food costs are arbitrarily dismissed as personal or household expenses and have never been deductible. The wages of the stokers who fire the factory furnace

[2] In the paragraphs immediately following, it is evident that we are dealing with so-called earned incomes. The costs involved in obtaining an investment income are in part tangible, in part intangible, though nonetheless real. Some tangible expenses incurred in managing investments are disallowed. The chief intangible cost is the risk or hazard involved in investment. Recognition of these intangible costs would strike at the very foundation of progressive taxation. Since profits tend to become equalized or adjusted at levels which allow for risk, there would be no case at all for progression if the risk factor were admitted as part of the cost of investment income.

are deductible, but not the wages of the domestic servant who prepares the worker's food. Keep in mind that in this and other illustrations to follow, we must not regard the individual as a personality, but as a mechanism for the production of a net income.

The business that uses plant and equipment may deduct all repair costs. The individual's repair costs are his expenses for doctor, dentist, surgeon, hospital and other medical care. Unless he can keep in good repair, he can no more continue to work than the broken machine in the factory. Yet none of his repair costs are deductible.

Again, the ordinary business unit is permitted to charge depreciation and obsolescence reserves against gross income, thereby making provision for the time when buildings and equipment will no longer be serviceable, or when they may become outmoded by new developments. Individuals depreciate also, and come eventually to a time when they can no longer work. Their particular skills may become obsolete even before they have become workers emeriti, because of changes of popular demand or of technology. The only provision that the individual can make against personal depreciation or obsolescence is insurance or some other form of savings. Yet nothing is permitted to him as deductions on account of these contingencies, although they are quite as certain to occur in the case of the individual as in the case of the machine and the building which houses it.

Finally, a business may deduct advertising and promotional costs. These are recognized as necessary to get new business, or to retain existing business. In the case of the individual, a certain standard of living is often required if one is to hold a particular position, or if one is dependent upon the goodwill of clients or customers. The expense of a mode of dress, or of entertainment, or of a house situated in the right section of town is, in reality, a necessary and unavoidable part of the cost of getting the income. That a good house, pleasantly situated, good clothing, good food, club memberships, and the like, are attractive and desirable, *per se,* is not to be denied. Yet these items are costs as obligatory as any other fixed charges in the case of many of the professional classes. If anyone attempted to eliminate them, the clientele or connection upon which his income depends would disappear.

No one can consider these and other possible illustrations of the defective character of the analogy between business net income and so-called personal net income and fail to perceive that the concept of a personal net income is so completely arbitrary as to be utterly false and erroneous. Nor is the exemption of 10 per cent of earned income from normal tax an adequate offset, for this is now worth, at most, only $56 reduction in normal tax.

In view of all the costs of getting personal income which should be recognized, and in view of the way in which these costs are

magnified as we move from low to high earned incomes, it seems reasonable to assume that if there be a disposable net personal income, it is a fairly constant function of the total income. It is extremely doubtful if this net income would increase in any marked geometrical ratio to total income. If this view of the matter is at all correct, it would follow that there is no good case for sharply progressive tax rates on so-called personal net incomes.

II

ABILITY AND PROGRESSION

Tax rate progression is generally considered to be the very essence of sanctity, the inner Holy of Holies in taxation, and only those who are so profane as to be lost in total fiscal depravity would even think of being critical.

It is my considered opinion that the error of theory and definition which underlies the current concept of personal net income is chiefly responsible for the assumptions upon which the doctrine of progression rests. The consequences of that error may be illustrated as follows: Assume that individuals A, B, and C have total incomes of $2,500, $9,500 and $19,500 respectively, and that each takes as a deduction only the $1,500 now authorized on account of marital status. Then, as the law determines taxable net income, we should have the following:

	Total Income	Statutory Deduction	Statutory Net Income
A	$ 2,500	$1,500	$ 1,000
B	9,500	1,500	8,000
C	19,500	1,500	18,000

Obviously, the restriction of each of these individuals to the same deduction, in lieu of any effort at correct determination of the true costs of earning the respective incomes creates an utterly false impression as to the relation between gross and net income. It creates an utterly false case for the kind of tax rate progression that we have had and that we now have. It implies that B is eight times as able to pay income tax as A, and that C is eighteen times as able to pay as A. Nothing could be farther from the truth.

It is difficult to avoid the conclusion that insofar as citizens and legislators think, or try to think, logically about the matter, they are persuaded that any degree of progression which fiscal expediency may appear to require is justifiable because of the apparently rapid increase of *net income* as total income rises. This increase is illusory, because of the undeniably greater cost of getting the larger incomes.

The 16th Amendment is as silent regarding the rate or rates of income taxation as it is with respect to the nature of income. Dur-

ing the past generation the doctrine that taxes should be paid according to ability was popularized and gained wide acceptance; but this doctrine accepted only one interpretation of the ability thesis, namely, that ability required the application of progressive tax rates.

As I have pointed out elsewhere, the whole complex of argument involving ability and rate progression has become firmly established on circular reasoning.[3] In this vicious circle, ability is defined to mean the use of progression, while progression is justified because it is an application of the ability principle.

An illustration of the kind of mental lapse which accepts this question-begging definition is the following, from recent testimony before the Ways and Means Committee:

> "Mr. Robertson: Mr. Sullivan, you referred to an 'ability' tax, that is, if a man makes $100 and the Government says 'Give me $10', he has got the ability to pay the $10, and that makes it an ability tax?
>
> "Mr. Sullivan (Under-Secretary of the Treasury): No; I refer as ability taxes to those taxes which are graduated in accordance with the ability of the taxpayer to pay." [4]

In the economic sense there is no mystery about ability to pay. It means, simply, the possession of, or command over, purchasing power. The manner in which this purchasing power comes and goes is also a clear and simple matter. It flows in and it flows out. It is like a moving stream, and the income which has been spent is thereafter no more indicative of ability, or economic energy, than is the water which has passed over the dam indicative of physical energy.

The total income which any one of us receives depends, like the flow of water in a stream, upon the size of the channel and the rate of flow. The current conception of ability and of progressive taxation assumes, in terms of the stream illustration:

> (1) That all of the income received during a year flows into a pool or reservoir and that the tax to be paid is properly to be determined by the total in the pool, and,
>
> (2) That the money to pay this tax is as certainly available at the end of the year as it would be if all income receipts for the year had actually been impounded.

Aside from the small number of persons who receive the largest incomes, there is no impounding of current income. The income of the ordinary person flows out about as fast as it flows in, principally in payment of the costs of getting that income. Any diversion of it

[3] "Romance versus Realism in Taxation," Lecture V, *The Business Man's Stake in Government Finance* (Stanford University, 1940), pp. 97 ff.

[4] *Hearings before the Committee on Ways and Means on Revenue Revision of 1941*, 77th Cong., 1st Sess., pp. 73-74.

by taxation should be made during this process. Under normally healthful economic conditions, even the largest income recipients would hoard relatively little income in the form of cash or bank deposits. Their outflow into investment, contributions, living costs, travel, and other channels would tend to approximate the inflow.

Whether the stream of income that flows through the pockets of any one of us be large or small, our respective abilities to pay taxes out of that stream are never greater than the stream itself. An annual salary of $3,000 equals a monthly pay check of $250, while an annual salary of $10,000 equals a monthly check of $833.33. The ability of the $3,000 man to do anything so far as current income is concerned, whether it be to pay taxes, or rent, or grocery bills or what you will, is never greater than $250 at any one time, and this peak is reached only twelve times a year. Certainly it is never as much as $3,000 at any time during the year, or on March 15th following. The ability of the $10,000 man to do anything at a given time is never greater than $833.33. It is wholly unrealistic to think of these cases in terms of an annual total of income because that annual total never exists at any one time, and even on paper it is merely a sum in addition. In basing progressive tax rates on annual income totals we are taxing sums in arithmetic rather than income.

It is true that the man whose monthly salary check of $833 is in a position to pay more tax than the man who gets only $250 per month, just as he is able to spend relatively more for anything else. And it is also true that at any proportional rate of taxation he would pay three and one-half times as much tax because of the difference in income. The devotee of progression may charge that I am merely shifting from an annual to a monthly or some other basis for the measurement of differences in ability. The supposed case for progression will be dealt with later. At this point it should be noted that insofar as that case rests on differences in true net income, there is no case until each of the above persons has been allowed to ascertain his economic surplus, that is, his true *net* income, after meeting all of the costs of acquiring the respective income.

The stock defense of the current tax practice is that each person who knows, or suspects, that he may be liable to income tax should budget his tax and set aside a reserve for that purpose. Many taxpayers do this, but what are they to do when heavy increases in income tax are made retroactive after a large part of the year has passed and a large part of the income has been spent?

Retroactive taxation is the very dregs of fiscal morality. To be sure, it is a perfectly valid practice in terms of, and in relation to, the current ability concept, namely, the view that the tax can and should be measured by the total income of the year. An integral element in this view is that ability is cumulative, that its existence is demonstrated by the arithmetical sum of all income receipts, and that the taxpayer is in possession, after the year has ended, of an

aggregate of ability which is to be measured by his total income. Under this doctrine, it would be logical and equitable to enact higher tax rates even after the taxpayer's fiscal year had ended, with retroactive application, for his ability to pay, as measured by an arithmetical total, is unaffected by the time factor.

Nothing could demonstrate more completely the unreal and unscientific and inequitable nature of the current ability concept than retroactive increases in income tax rates. Yet this practice has been a common feature of income tax legislation from the beginning. It is likely to persist until we can substitute a realistic and commonsense attitude toward income taxation for the uncritical and romantic attitude which has hitherto prevailed. I shall presently refer to some aspects of the latest version of ability taxation, namely, the Revenue Act of 1941. At this point it is appropriate to note the effects of retroaction on the range of incomes most severely affected thereby.

The following table shows the total tax increase for a married person, according to the rates proposed in the Senate Bill.[5]

INDIVIDUAL INCOME TAX FOR MARRIED PERSONS

Statutory Net Income	Total Tax under 1940 Law	Total Tax under Senate Bill 1941	Increase of Tax, 1941 over 1940	Average Monthly Income
$ 1,600	——	$ 6	$ 6.00	$ 133.33
2,000	——	42	42.00	166.67
3,000	$ 30.80	138	107.20	250.00
4,000	70.40	249	178.60	333.33
5,000	110.00	375	265.00	416.67
6,000	149.60	521	371.40	500.00
7,000	233.20	687	453.80	583.33
8,000	316.80	873	556.20	666.67
9,000	422.40	1,079	656.60	750.00
10,000	528.00	1,305	777.00	833.33
15,000	1,258.40	2,739	1,480.60	1,250.00
20,000	2,336.40	4,614	2,277.60	1,666.67
25,000	3,843.40	6,864	3,020.60	2,083.33
30,000	5,614.40	9,339	3,724.60	2,500.00
50,000	14,128.40	20,439	6,310.60	4,166.67

By the time the bill was enacted, only about three months remained in which taxpayers could make provision for the increase. At $5,000 of net income, the increase would require more than half a month's pay. At $15,000, it would require more than a month's

[5] Senate Committee on Finance, *Report on the Revenue Bill of 1941*, 77th Cong., 1st Sess., Rep. 673, Pt. 1, p. 7.

pay. At $50,000, it would require more than half of all income to be received from October 1 to December 31.

It will be unwise for individuals to carry much of this increase into 1942, for they will be obliged to begin budgeting a full year's tax at the new rates against their 1942 incomes. And while fiscal morality remains on its present low plane, they may get another dose of retroactive taxation next year.

The final effect of this kind of taxation may be anticipated to be—increased deferment of current bills, loans on insurance policies, borrowing from banks and personal finance companies, and liquidation of securities or other property. Reduction of individual net worth, in whatever manner it occurs, which is caused by an unsound and unfair method of taxation and not in any degree by personal improvidence, means that the 1941 income tax will really be a levy in part on capital rather than on income.

As I have said elsewhere, the budgeting theory of personal income tax payment is evidence that this tax is applicable, administratively, only to the well-to-do.[6] A tax, based on the total income received in one year, to be paid in the following year, requires the accumulation of a tax reserve. There was great jubilation over the Senate action in reducing personal exemptions to $750 and $1,500, as being a move in the further broadening of the income tax base. Editors became almost poetic in their raptures. More careful consideration of the figures reveals, however, that the change will have very slight effect in reaching the low income group and that its principal result will be to increase still more the taxes to be paid by those who have always paid income tax. According to data in the Conference Committee report, the returns to be made and the revenue to be anticipated are as follows:[7]

	Married	Single	Total
Additional Returns	4,453,000	477,000	4,930,000
New Taxpayers	1,850,000	425,000	2,275,000
Additional Revenue from New Taxpayers			$ 47,000,000
Additional Revenue from Old Taxpayers			256,000,000
Total Additional Revenue ...			$303,000,000

There is a high proportion of chaff to wheat in these new returns, and very little wheat in any case. On the basis of the whole number of returns the tax will be less than $10 each, and for the new taxpayers who will actually pay the tax it will average somewhat more

[6] *Hearings before the Committee on Finance on Revenue Revision of 1941* (H. R. 5417), 77th Cong., 1st Sess., pp. 1283-1302.

[7] *Report of the Conference Committee on the Revenue Bill of 1941*, p. 10.

than $20. The vice of progression is that in the case of old taxpayers, the amount removed from the exemption increases the amount taxable at the highest bracket. Thus, while the individual's allowance against the costs of getting his income is reduced, his tax is increased at a rate determined by the highest bracket into which his income falls. As a device for a genuine large-scale extension of income tax, and for tapping substantially the vast pool of mass purchasing power in order to provide a check on inflation, the action of the Senate Committee was a dismal failure.

No one, in the Treasury or out of it, appears to have had any conception of the inappropriateness of this method of taxing small incomes. Granted that the new income taxpayers are disposed by temperament to put aside a reserve for taxes (an extreme and highly improbable assumption for the great majority of them), it would have to be a cash hoard, as few of them have bank accounts, and fewer still have safety boxes. The risks of losing cash, or of using it for other purposes than taxes are too obvious to be emphasized. The tax stamp plan is subject to the same objection. Mr. Morgenthau's scheme of a simplified table to aid small taxpayers in computing their tax is ingenious, but it misses the main point, which, for the little fellow is—Where do I get the money to pay my tax after I have spent it on other things? Some day perhaps we may have the intelligence and the courage to admit that while small incomes should be taxed, they cannot be taxed under the present type of income tax administration.

Even the most careful tax-budgeting plan encounters serious difficulties in case of irregular incomes. The amount to be set aside for income tax out of each item of income receipts will obviously depend upon the total receipts for the year. Insofar as this total is irregular or unpredictable, no rational tax budget can be set up. For example, suppose that an individual should decide, on January 1, that in view of his probable income for the year, his effective tax rate will be 20 per cent. Prudence would require that he set aside 20 per cent of each item of income as received. But suppose that in the second half of the year he receives an extra dividend, or a fee, commission, or bonus, or some other unanticipated item, in an amount which would make his effective rate 40 per cent. The absolute amount of the unexpected receipt required to produce such a rise would depend on the steepness of the progression. Having put aside only 20 per cent up to that time, and having spent or invested the other 80 per cent, the only way to meet the tax bill will be to set aside all or a large part of the unexpected receipt. But a rational person would then ask himself, "What is the use to try to increase my income when in doing so I am simply working for the Government without pay?" The only rational answer is that there is no use.

III

FURTHER DEFECTS IN THE ABILITY-MEASURED-BY-PROGRESSION CONCEPT

Some of the defects in the ability-measured-by-progression concept may be reviewed and summarized as follows:

(1) *The assumption that all income received above the meager statutory deductions allowed to the individual is a true net income or true net economic surplus, any or all of which can be taken in taxes.*

Experience has shown that a little progression is not possible. It is about as difficult to go a little way with progression and stop, as it is to jump a little way off of the top of a high building. The concrete application of the above assumption by a succession of increases in income tax rates has been most severely directed, in recent acts, against the lower and middle bracket income groups. The untaxed statutory net income of these groups has long been regarded as a happy hunting ground in any effort to increase the revenue. But it is precisely in these income ranges, in which the income is comprised predominantly of wages, salaries, and other forms of earned income that the statutory net income concept is most inapplicable and misleading. It is here that those costs of getting income which are in such large measure disallowed by the current tax practice bulk largest. In consequence, neither the statutory rates of levy nor the effective rates are a reliable index of the true burden of the income tax.

(2) *The assumption that ability is cumulative and is registered by total income receipts.*

The principal reason for the reliance on this fallacy is that progressive taxation requires it. It would be impossible, obviously, to undertake any kind of withholding or collection of the tax at source at progressive rates. Faced with the dilemma of realistic income taxation without progression or the use of an unrealistic income and ability concept adapted to progression, we have steadily, but in my judgment unwisely, chosen the second alternative. As I have pointed out above, retroactive increases of tax rates, even if delayed until December 31st, or until some date in the following year, as happened in 1918-1919, are logical and equitable because they are wholly consistent with the underlying conception of income and ability. From the viewpoint of common sense and fundamental fair treatment of the taxpayer, a retroactive increase of tax is the clearest possible evidence of the unsoundness of this conception.

(3) *The assumption that large income receipts in one year only, or even during a few years, may be taxed as heavily as if receipts in such volume were assured in perpetuity.*

The question of the relation of the duration of income receipts to the ability to pay any particular proportion of the total in income tax is a familiar one, but it has never been faced any more frankly than many other issues. Indeed, there is a strong inclination to apply the specious word "windfall" to such receipts and to deal with them even more severely on this account. Upon the showing of one individual, the Revenue Act of 1939 contained a provision which permitted that lump-sum payments for personal services extending over a period of five years or more should be taxed at no greater amount than would have been paid if the compensation had been paid in equal annual installments over the years of service for which the compensation was paid. The terms of this provision are so narrow, however, as to exclude many who might, with reason, have a similar case. Such persons fall into two groups:

(a) A group of persons who attain substantial earning power early in life and who, for one reason or another, quickly lose that advantage. Good examples are motion picture performers whose income depends on glamor or youthful charm, and baseball players and other athletes whose earning power depends on the physical prowess of early maturity.

(b) A group of persons in the learned professions and in business who rise slowly to the top and receive substantial incomes for a few years near the close of active life.

In the first set of cases, the high annual earnings pass quickly, and if a large proportion of these earnings is taken in taxes, as would be entirely proper under the current justification of progressive taxation according to ability, there may be little left for the support of the recipients during the remainder of a long life of low earning power, when the principal solace is a review of one's newspaper clippings. In the second set of cases, the high earnings come only after many years of low income, hard work, study, and laborious self-improvement. During this long apprenticeship, when the income was small and was largely or wholly absorbed in the costs of professional or business advancement, there was no opportunity of providing for the future. A long-range view of the situation presented by any one in either of the above categories would reveal that the large earnings of a few years represent only a reasonable annual income over the whole working lifetime of the person concerned. Such persons cannot qualify under the provisions of the Act of 1939, but there can be little question that they would be as fully entitled to this relief as is anyone to whom that Act may be applicable.

It may be objected, here, that the accretion of borderline cases to each of the categories suggested above would presently result in everyone having some kind of good case for not being subjected to such severe taxes as are now applied. The determination of boun-

daries would be difficult, but in my opinion many persons do have a good case against the kind of taxation to which the present income tax subjects them. The correct solution of general application lies in the direction of modifying the entire rate structure, and even in changing the whole approach to the income tax itself. It is not to be found through the perpetuation of obvious injustices.

(4) *The assumption that the amount of income tax paid has no bearing upon ability, or in other words, that an individual's ability is to be measured by his income* BEFORE *taxes rather than by his income* AFTER *taxes.*

It has always been customary to permit the deduction of taxes other than those levied upon income. The logic of this deduction is that the taxpayer can have no permanent personal use and enjoyment of that part of his income which is actually to be taken by some governmental agency in the form of taxes. With respect to such income the recipient is simply a custodian until tax payment date.

But the same logic should apply in the case of taxes levied upon the income itself. From this point of view there is no difference, either theoretical or practical, between the taxes paid on property, for example, and those paid with respect to the income itself. In each instance the taxpayer is a mere custodian. In both cases the tax is paid out of income. In neither case can it be said that the taxpayer has any permanent personal use or enjoyment from that part of his income which must be surrendered to the government.

Insofar as ability means possession of or command over purchasing power, it is clear that everything taken by government must be excluded from his effective purchasing power and not simply a part of that "take". Under the procedure that has always been followed, both individuals and corporations are subjected to substantial taxes on taxes.

The stock answer to this criticism is that if the federal income tax paid in any year were a deductible item against the income of that year, it would be necessary to raise the rates still higher on the income after taxes in order to produce the same revenue. This implies that there is some set or previously determined figure which represents the revenue that the income tax must produce so that if the total is not secured in one way, it must be obtained in another way. Obviously, such is not, and never has been, the case. Even in the Treasury no one knows just what will come in until they start weighing the mail-bags during the first two weeks of March.

The income taxpayer is always the one to hold the bag in all cases of clever manipulation of revenue bills. Thus, when various tax schemes are incorporated in a tax bill and are eliminated during the legislative process, the price of their elimination is always a further mark-up of the income tax. As in the case of the lowered exemp-

tion, this always results in a heavier burden on those few who have always paid this tax than on anyone else.

(5) *The assumption that the only obligation of an individual or of a business is to support the government.*

One defense of progression, even of steep progression, that is very commonly encountered may be phrased thus—"But see how much so-and-so has left after paying his tax. I'm sure I could live on that."

This viewpoint evidently underlay the late 19th century discussions of progression in terms of equality of sacrifice, or equal marginal sacrifice. It was naïvely assumed, even by economists who were in other respects hard-headed, such as T. N. Carver, that government was entitled to all individual income receipts down to a level at which the sacrifices of further tax payment were equalized.[8]

In this viewpoint, the explanation of how the private economic system was to be supported and expanded through private capital investment was apparently left in the same unsatisfactory condition as that story of an earlier generation about the new baby being found under the gooseberry bush.

I have made the suggestion before, and I renew it here, that we should be willing to do as well by the enterprise system as we do by charity. That is, we should allow a credit against gross income on account of investment, up to, say 15 per cent of the income. At the present time, I would go farther, in the case of business concerns, and allow a credit of 15 to 20 per cent of income, to be earmarked as a "depression reserve". The current rates of income and profits taxes mean that American business will go into the next depression with a cupboard entirely bare. Only the most short-sighted view of fiscal statesmanship, or the most diabolical opposition to the enterprise system, could persuade anyone that we shall need no shock-absorber next time. If we are so foolish as to pursue the present policy, the outcome will be greater business prostration than in 1932, bigger and better deficits, a stronger condemnation of the private enterprise system, and a louder demagogic plea to transfer all capital to the federal government.

IV

THE CASE FOR PROGRESSION

If we break apart the vicious circle of ability and progression, in order to find what support the one has apart from the other, we see that with respect to progression, its principal basis is the pragmatic one of public policy. The people like it and want it, chiefly because only a small minority is affected by it, hence it has a well-nigh

[8] T. N. Carver, "The Minimum Sacrifice Theory of Taxation", *Political Science Quarterly*, Vol. XIX, p. 66 (March, 1904).

impregnable position in taxation practice. Professor Haig has explained the popularity of progressive taxation as being "traceable in no small part to the opportunity which it offers in a democratic state to place added burdens upon the group which, while economically strong, is often politically weak." [9]

Such an explanation affords abundant basis for the political fact that tax rate progression is firmly embedded and cannot be removed until it has accomplished its deadly work, but it provides no clue whatever to the intellectual or logical foundation upon which the doctrine rests. Anything as firmly fixed in practice as is progression needs no support in logic. The people know a good thing when they see it, and they see in tax progression an excellent opportunity to make someone else pay the bill. That is, they think they see this, and no one has undertaken as yet to show them another angle in the case.

It is now thirty years since the late Professor F. W. Taussig first asserted that the only good case for tax progression was the socialist goal of redistributing wealth.[10] This position was taken in 1911, when the only examples of progression then to be observed were the very moderate rates levied on inheritances by the states and a few historical instances of equally moderate income tax progression. It has been abundantly confirmed by the inordinate excesses of progressive taxation which have been committed since that time, and by the frank admissions of purpose which have been made by those responsible for those excesses. For many years, I, like virtually all of my colleagues in the field of public finance, disregarded Taussig's analysis, but I have come at last to the conclusion that he was right.

No one has seen more clearly than Taussig the shaky connection between ability and progression, or expressed the matter more aptly.

[9] R. M. Haig, "Taxation", *Encyclopaedia of the Social Sciences*, Vol. XIV, pp. 539-540.

[10] "Any conclusion, then, in favor of progressive taxation and of higher taxation of funded incomes must rest, to be consistent, on a frank admission of unwelcome features in existing society and on a program of social reform. The only question, then, will be whether this particular mode of reform, through taxation, is likely to work well, whether it may not bring evils in its train, whether other ways toward the same end are not better. And here there are serious reasons for doubting the wisdom of such measures, and certainly for proceeding with great caution in their application. . . .

"Progressive taxation, so far as it aims to correct unjustified inequalities, evidently deals with results, not causes. It is obviously better to go to the root of the matter, and to deal with the causes. Much the more effective and promising way of reform is to promote the mitigation of inequality in other ways—by equalization of opportunity through widespread facilities for rational education, by the control of monopoly industries, by the removal of the conditions which make possible illegitimate profits. Progressive taxation, which deals with income (or property) solely according to size, and not according to social desert, is less discriminating and also less effective in reaching the ultimate goal than the various ways of spreading material welfare which have been considered in the preceding pages."—F. W. Taussig, *Principles of Economics* (1st Ed., 1911), Vol. II, p. 492.

No advocate of progression has ever given an adequate and convincing answer other than the socialists' answer to the question—Why should anyone be forced to contribute to the support of government on a basis different from that on which he contributes to the support of the other parts of the economy?

Reduced to its essentials, government is simply a form of social organization, established to do certain things for the people which can be done better, and sometimes more cheaply, by joint action than by group or individual action. In the economic sense, government operations involve the use of labor and capital, and in this respect they are precisely similar to the operations of private enterprise. The rank and file of government employees are no more able, or industrious, or productive than the rank and file of private employees. The executives who direct public employees are sometimes persons whose record in directing or managing private employees has been conspicuously unsuccessful.

The basis of our support of the workers in the private sector of the economy is the system of prices. By purchasing the goods and services produced by private workers, we support those engaged in the vast and complicated mechanism of private enterprise. The price system is proportional throughout at the level of retail prices. The ability principle operates here by strictly according to proportion. Those with large purchasing power can and do give relatively greater support to privately employed workers than those with small purchasing power. But, per unit, a given article is sold to all and sundry at the same basic price per unit. No one is required to fill out Form 1040 to enable a merchant to determine how much to charge him for bread or shoes or coal.

Taxation is the method by which the workers in the public service are supported. If we accept the idea that taxation should be used primarily to provide funds for this support, and not to equalize wealth and incomes, the defense of a different basis for determining our respective contributions to the support of public employees than is used to determine the measure of our support of private employees must rest on the thesis that government is so much more important than private economic activity as to be incommensurable with it.

But this thesis cannot be supported except by conceding that there is validity in the doctrine of the super-state, transcendent above all other human and mundane affairs. The dangers of this doctrine, particularly for a people devoted to the democratic tradition and way of life, are too obvious to require further comment.

It is futile, on any other ground, to undertake the imputation of any marked superiority to the services of government over the services of industry, trade, the professions, and all else that enters into private enterprise. Good government, when it does not cost too much, is undeniably beneficial to enterprise. But no government can exist without an economic foundation, whereas some economic

activity persists even amid the most chaotic governmental collapse. Government and private economic activity alike have no meaning and no purpose apart from their respective contributions to the general wellbeing, and from this standpoint it is impossible to concede that any government transcends the private economy from which it must derive its support.

We come back, then, to the disagreeable fact that progression is an accepted feature of public policy, and because of this fact it can dispense with logic and theory. The answer to this must be equally hard and blunt—and it must be in terms of an appraisal of that policy. Is it good or bad?

From the standpoint of the immediate present, the evidence is in its favor. Public expenditures can be larger, and they can be covered without such taxes on the masses as would be required otherwise. If these expenditures involve deficits, the government's credit is sustained by the fact that as long as the progression has not become total and complete confiscation, a margin of income or property remains to be subjected to still heavier taxes.

From any point of view which extends beyond the immediate present, the policy is definitely bad, and even the temporary advantage becomes illusory. Progressive taxation is bad policy for two reasons:

(1) It negatives or nullifies the most important force which makes a country great, which enables its citizens to prosper, and which raises the standard of living. This force is the profit motive.

(2) It is a method of impairing and depleting the capital fund which can only be likened to "eating the seed-corn" or "burning down the house to keep warm".

(1) *The profit motive.* The dynamic force in any society in which private property and private enterprise are recognized is the hope or prospect of gain. This has been the force which has made our own country great—a country with the highest standards of productivity and of living in the world; a country in which a bill of rights is still believed by some to have significance; a country in which breathtaking exploits in the discovery of new products, the development of new industries, and the satisfaction of new wants, have been more numerous than in any other.

It is a commonplace of economic theory that profit must be commensurate with risk. Since no scheme of taxation can appraise differences in risk, the leveling influence of heavy tax progression is at once apparent. Risks of any magnitude are not worth taking, cannot, in fact, be taken, if the larger gain which must be in prospect as an offset to the risk is expropriated in substantial measure through taxation. The decay of enterprise, which some have attributed to a

sudden and subtle change in the human spirit caused by the great depression, was not produced by the depression. It was caused by the killing taxes on the fruits of enterprise which have been made more severe by every tax act since, and including, the Act of 1932.

(2) *Eating the seedcorn.* The most shortsighted aspect of progressive taxation of incomes and estates is the naïve assumption that wealth or income can actually be redistributed or equalized by the process. An apparent approach to equality is achieved, but this occurs through the destruction of wealth and income. Those who expect to realize significant social gains through progressive taxation are quite unaware that in the end the equality which they seek is far more likely to be on an income level below than above the present average.

The same fallacy which is encountered in all schemes for a capital levy is encountered in the notion that wealth or income can be redistributed through taxation. The current valuation of the nation's wealth, and the current volume of national income, are alike expressive of values produced by a vast institutional complex of property ownership, managerial capacity and business organization. Any forcible disturbance of this complex will impair its functioning and materially lessen the values created. In this case the parts are equal to much less than the whole after dismemberment has occurred.

One evidence of the effect of eating the seedcorn of wealth and income is the emergence of unemployment as a chronic phenomenon. It has appeared in England, Germany, France and the United States coincidentally with the increased pressure of progressive taxes on incomes and estates. For a decade we have sought to eliminate unemployment on the theory that its cause was a lack of consumer buying power, to be remedied by creating and distributing more purchasing power through huge public deficits. Its cause is more propertly to be found in the impairment of capital and of the incentive to provide capital following the expansion of progressive taxes. Thus we get a vicious circle—government soaks the rich to take care of the unemployed, and the more the rich are soaked, the more unemployed there are for whom provision must be made.

While taxation for the support of government is a primary obligation of every citizen, it is not his sole obligation or responsibility. Extreme progression implies that there is nothing else to be done with the surplus part of any income or estate except to surrender it to the government. This ignores or neglects the requirements of the capital fund and the productive equipment of the nation, from which come both our sustenance and our taxable capacity. In earlier times the doctrine of thrift and investment had an individualistic emphasis—each one should save and invest something from his income as a means of providing for his own future. It was no doubt perceived, though it was not emphasized, that when everyone followed this

course, he was contributing to the present and future well-being of others as well as of himself.

The doctrine of individual thrift has declined as the doctrine of progressive taxation has risen. Increasing taxes not only make thrift less possible, but they extend the hazards of investment. Since the revenues collected through progressive taxation are not applied to capital creation, but are spent for current operations or for non-reproductive durable goods, the effect is, inevitably, a depletion of the nation's capital fund. It would be in some degree justifiable to eat our seedcorn of capital if we were in such desperate straits that survival depended on this course. We are not in this plight. We are strong and wealthy. To eat the seedcorn under the illusion that we are thereby permanently bettering the condition of the people is a ghastly fiscal tragedy.

A final phase of the defense of progression is encountered in the proposition that such taxes are proper, provided that government uses the revenue for capital rather than for current purposes. This line of thought was somewhat popular in the early days of heavy inheritance taxation, or what was considered twenty-five years ago to be heavy inheritance taxation.

As a protest against eating the seedcorn the proposal had merit, although it has never been recognized by any tax-levying or appropriating body. As a defense of progression, it is without sense, unless it can be shown to be sensible to tear down one house merely to use the materials to erect another similar house. The result of the wrecking operation performed by the tax would be, of course, to transfer ownership of the house from private to public hands, and this is precisely what socialism is.

We are engaged today in a process of consuming our resources at a high rate in order to strengthen the national defense. If some persons had their way, we would be, even now, in a shooting war. Our lofty objective is said to be to end aggression, but the economic and political philosophy which underlies the policy of aggression is national socialism. At bottom, therefore, we are opposing, and we may presently be fighting against, national socialism. Yet we are traveling the road to national socialism as fast as the Devil can send us. To those who abhor socialism, and who see the contribution which progressive taxation is making toward the realization of socialism, the whole doctrine of progression must appear, indeed, to be the work of the Devil himself.

V

FISCAL AND ADMINISTRATIVE DEFECTS OF THE INCOME TAX

(1) *Fiscal inadequacy.* Despite the inaccurate and indefensible statutory concept of individual net income, the revenue obtained from the income tax has been highly uncertain and undependable.

The statistics on this point are too familiar to require repetition. Whether the return under a given act be large or small, this yield is necessarily inadequate from the standpoint of prompt availability. The administrative procedure of levy and collection required by the use of progressive rates renders this inevitable, for the taxes levied against the income of a given year are not finally collected in full until after the expiration of virtually another full year.

The effects of this delay on the budget are serious, particularly in a period of rising governmental costs. A conspicuous illustration is provided by the Act of 1941, which was deemed, in April, to be sufficient to assure a ratio of two-thirds taxes and one-third loans, but which was declared by the Treasury in August to be wholly inadequate. As a matter of fact, it was inadequate in April, for the suggested ratio of loans to taxes could have been achieved in the fiscal year 1942 only if the full estimated yield of the tax could have been realized in that year. This was obviously impossible.[11] By the time the 1941 Act was passed, the total estimated expenditures for the fiscal year 1942 had risen to $22 billions, and Mr. Morgenthau conceded that the total might be nearer $25 billions,[12] but the contribution of the Act of 1941 during the fiscal year 1942 would still be some 40 per cent less than its estimated full yield.

It must be admitted that inasmuch as all accepted standards of sound budgetary practice have been discarded, there is less need of concern over when, if at all, the money is collected. This becomes doubly true when the income tax is used primarily for other than budgetary purposes. It is clear, however, that an administrative procedure which is as sluggish in its fiscal response to rate changes as the present income tax is not a high-grade piece of good budgetary equipment.

(2) *Uncertainty.* Aside from belated proposals for retroactive tax increase, the principal source of uncertainty for income taxpayers lies in the delay and confusion involved in the determination of statutory net income. All are familiar with the complaint that the

[11] Note the contradictions in the following statements by Mr. John L. Sullivan, Under-Secretary of the Treasury: (*Hearings before the Committee on Ways and Means on Revenue Revision of 1941*, pp. 47-48)

". . . In terms of the $19,000,000,000 expenditures now indicated for fiscal year 1942, this requires a tax system yielding $12,667,000,000. Present taxes are expected to provide $9,223,000,000, leaving approximately $3,500,000,000 to be raised by new taxes. The Treasury's program is designed to produce approximately this amount. . . .

"In the first full year of their operation the Treasury's revenue proposals are expected to yield approximately $3,600,000,000 of net additional reenue. . . .

"It should be noted that much of the increase in this tax will not be received during fiscal 1942. The lag in payments will delay the collection of about 40 percent of it until fiscal 1943."

[12] *Hearings before the Committee on Finance on Revenue Revision of 1941* (H. R. 5417), p. 18.

property tax involves too great reliance on the judgment and discretion of property tax assessors. Yet the property tax is a marvel of scientific objectivity by comparison with the income tax. It is true that even the best accountants will differ as to proper treatment of capital asset values, inventory values, depreciation, depletion and so on. Since these matters are in the realm of judgment and discretion, it is to be expected that differences of opinion may legitimately arise between government auditors and taxpayers' auditors. Resolution of these differences takes time.

But that is precisely the point here. The nature of the tax base is such that, even with the best of intentions on both sides, a considerable delay and uncertainty are inevitable. The wider these differences, the greater the burden on the taxpayer in time, money and energy to defend his position. When the intention ceases to be good, and this has happened on each side, the burden is greatly increased.

A peculiarly objectionable practice that has developed under the income tax, in a degree far greater than under any other tax to my knowledge, is the systematic setting of quotas of back tax to be collected, and the pressure put on examniers to fill their respective quotas. Many stories have been told of cases in which the zeal of examiners to fill their back-tax quotas has led to transfer of items from one year to another to the net advantage of the taxpayer and the net disadvantage of the Treasury. There is something obviously and fundamentally wrong with a tax which lends itself to this sort of abuse.

(3) *An instrument of personal government.* The form of civil action which most people dread above all others, probably, is a suit alleging fraud in income tax return. This arises not only from the severe penalties inflicted upon conviction, but also from the publicity necessarily given to private affairs in the defense of such a suit. It follows, therefore, that the mere threat of prosecution for income tax fraud is a powerful weapon in the hands of those who may seek to rule by personal whim rather than by and under the law. Again, many stories have been told by persons whose integrity I have no reason to question, which suggest the use of the threat to sue, even while admitting no case, as a means of enforcing claims for additional back tax, for opening returns after the period of limitation has expired, and for other purposes.

It may be said that if such things be true, they are abuses which can and should be corrected. That is true, but the fact remains that here is a form of taxation which, since it deals in a highly inquisitorial way with all of the details of the most private personal affairs, is peculiarly susceptible to various forms of blackmail. It is hardly too much to say that they are inherent in this method of taxation.

VI

THE REVENUE ACT OF 1941

In conclusion, certain aspects of the Revenue Act of 1941 will be commented upon briefly, primarily for the purpose of bringing to your attention the kind of argument that was used to support some of its provisions.

The 1941 Revenue Act should be called the Rip Van Winkle tax law. It is what might have been expected, in the way of tax legislation, from Rip Van Winkle if he had gone to sleep shortly after the Armistice and had awakened in the spring of 1941. It was simply the World War tax program and no more. There was no recognition whatever of the changes in fiscal policy, needs, and outlook that have occurred since the Armistice. There was no appreciation of the vast difference between entering upon a world war with a public debt of $1,225,000,000 and entering upon such a war with a public debt of 50 billions or more.

Some of the arguments advanced to support certain provisions of the bill were disingenuous, to use a polite term. For example:

(1) In lieu of a surtax scale beginning at $4,000, all net income above the credit for marital status and dependents is to be treated as surtax income. The reason for this was given by Mr. Sullivan as follows:

> "At the close of the last fiscal year the amount of such securities (i.e., partially tax-exempt Federal securities) outstanding totaled $35,000,000,000, $8,000,000,000 of which was in the hands of individuals. These securities are exempt from the normal tax but not from the surtax, and any increase in the rates of the normal tax as opposed to the surtax would enhance the value of the tax exemption. . . .
>
> "If you are going to make the fellow who works in a shoe shop and gets $21 or $20 a week pay a tax, it is not going to make him feel very good when he discovers that in the same law there is an exemption in favor of partially exempt securities of which the President of the local bank has a sizeable amount, and this bill was worked out in such a way that the banker is not going to pay any tax on the income from these securities." [13]

The implication is that persons with surtax incomes under $4,000 hold a large part of the partially-exempt securities imputed to individual ownership. A few years ago the Treasury was contending that the various kinds of tax-exempt securities were chiefly owned by the rich. In fact, Mr. Sullivan's illustrative case, the bank president, provides an ironic comedy contrast with those who are now

[13] *Hearings before the Committee on Ways and Means on Revenue Revision of 1941*, pp. 48, 60.

to be subjected to surtax because they own partially-exempt bonds. A bank president who paid no surtax under the 1940 Act could not be exposed to serious envy on the basis of income disparity. Mr. Sullivan made a plain misstatement in saying that the president of the local bank would pay no tax on partially-exempt securities, for the interest on such securities is subject to surtax.

The Ways and Means Committee report gives the details of tax computation in a hypothetical case.[14] This person was assumed to have had total income of $11,000 and net income of $9,400, including $300 of partially-exempt interest. Under the 1940 Act his total tax would have been $418. Under the original Treasury plan it would have been $957. Taking the purpose of this increase in taxes to be that offered in explanation, it appears that an individual receiving $300 in partially-exempt interest is to have a tax increase of $539 because of that fact. I pass over the millions of individuals who own no partially-exempt securities, and also the fact that those who do own them have acquired them at a price which took into account the value of this limited exemption. The government sold these securities on a more favorable basis for itself because of the exemption than would have been the case otherwise. It now proposes to revoke this agreement by juggling the terminology of the tax law.

A graduated corporation surtax of 5 and 6 per cent was also proposed, on the ground that corporations held a large quantity of partially-exempt securities. Despite the admitted fact that banks and insurance companies hold almost the whole of the total owned by corporations, and that they, too, gave the Treasury the full return for the partial exemption in the purchase price, the surtax is to apply to all corporation income. In consequence, the estimated yield of the surtax was $535,000,000 in April, and $645,000,000 in July. At the 6 and 7 per cent rates of the Senate bill, this estimate becomes $765,200,000, or close to 60 per cent of the total federal interest paid.

I am not arguing here against higher taxes on either individuals or corporations. I am criticizing the failure to be frank, and the use of "phony" arguments designed to appeal to mass prejudice rather than to common sense.

(2) *The compulsory joint return.* Compulsory joint returns were eliminated by the House. I have always opposed this practice, as I have opposed any proposal to violate community property laws.[15] Here I am concerned solely with some of the arguments advanced by the Treasury in support of the compulsory joint return.

[14] *Report of the Ways and Means Committee on H. R. 5417*, p. 6.

[15] *Cf.*, H. L. Lutz, "The Privilege of Personal Income Taxation", *Bulletin of the National Tax Association*, Vol. XXIII (October, 1937), p. 11.

(a) It was said that wealthy persons have transferred large amounts of property to their respective spouses in order to reduce personal income tax. Thus, Mr. Morgenthau said:

> ". . . Families pay lower Federal income taxes when both husband and wife receive incomes than when the same total amount of income is received by only one of them. This is a discrimination of which many wealthy people have taken advantage by large gifts of income-producing property between husband and wife."[16]

But in this implication that all a rich man has to do to avoid high-bracket income taxes is to transfer property to his wife, nothing at all was said about the gift tax. It would cost a rich man 75 per cent as much to make a gift to his wife as it would cost his estate if he died and left the property to her.

Suppose a man contemplated giving his wife income-producing property worth $1,000,000, thereby reducing his own income by some $40,000 at the present rates of return. Under the 1940 gift tax rates, the transfer would have cost him $178,410, and under the proposed rates of the Senate bill the cost would be $244,275. The husband's saving in income tax, assuming him to be subject to the highest bracket rate, would be perhaps $31,000. But the wife's tax on the income from the net gift would be about $10,000. The over-all family tax saving would therefore be around $21,000, assuming a 4 per cent return. If the gift tax of $244,000 be considered, it would take a long time to show a profit in the tax avoidance account under these conditions. If rich men give large sums to their wives, the purpose must be something other than income tax avoidance, and they already will have paid heavily for such tax reduction as they may secure.

An effort was made to meet the divorce angle of the compulsory joint return controversy by saying that such had been the practice in England since 1914 and that the English divorce rate is not as high as our own.[17] It was not pointed out that in England the only recognized ground for divorce until recently was a violation of the Seventh Commandment, proved circumstantially by the testimony of waitress, chambermaid and a copy of the hotel registration, while in the United States the beautifully vague and flexible terms, "mental cruelty" and "incompatibility", have served in thousands of cases.

(3) *The special 10 per cent tax on profits.* The House Committee accepted the Treasury scheme of taxing, at 10 per cent, any increase of profits over average base period earnings, in cases where the invested capital basis was used but where the earnings did not equal the 8 per cent of invested capital allowed as an excess profits credit.

[16] *Hearings before the Committee on Finance on H. R. 5417*, Pt. 1, p. 3.
[17] *Report of the Ways and Means Committee on H. R. 5417*, p. 14.

This is a clear case of repudiation. The 1940 excess profits tax expressly provided that when the invested capital base was used, an amount representing certain percentages of that base should not be deemed to be excess profit. The Ways and Means Committee followed the Treasury lead in the following naïve explanation of this provision:

> ". . . many corporations which are making added profits directly or indirectly attributable to Government expenditures for the national defense are paying no additional taxes upon such profits. It is felt that such corporations, benefiting so substantially from the defense expenditures, should make a larger contribution from their increased income even though their income for the taxable year is still less than the invested capital credit." [18]

When the Second Revenue Act of 1940 was written, it was clearly understood and anticipated that many corporations would make more money than they had been making. The use of the invested capital base, with rates of 8 and 7 per cent on this capital to determine the excess profits credit was a plain recognition that earnings should reach a certain level before there could be any supportable charge of excess profits being made out of defense business either directly or indirectly.

Had the 10 per cent tax been retained, it would have offset, in large degree, the 25 per cent extra allowance for new capital, in the case of companies required to pay this tax. The allowance was made, in the Committee's words, " In order to encourage the investment of new capital in corporate enterprise." [19] Having regard for all that the bill does, otherwise, to discourage investment, this provision sounds like a salve to conscience rather than a serious effort to revive venturesome investment.

Since this devious method of repudiating an earlier tax law has been deleted, no further comment is required. It illustrates, however, the kind of twisted thinking to which the general category of taxes on income appears to be particularly susceptible.

(4) *Reversal of the deduction for income and excess profits taxes.* On this subject I quote from my statement to the Senate Finance Committee:

> ". . . With respect to measuring excess profit by earnings before deduction of ordinary income tax, it is clear that there can be no question of earnings or profits of any sort until all of the fixed charges have been met. The ordinary corporation tax, having been in effect since 1913, and being intended to

[18] *Ibid.*, p. 25.

[19] *Ibid.*, p. 26.

remain in effect long after the excess profits tax will have been repealed, is certainly one of these fixed charges. Whether a corporation has earned normal, sub-normal, or excess profits in relation to average base period earnings or invested capital is a matter of significance only as it indicates the relative return to shareholders. Whether that return is to be regarded as more or less than it should be is a question that can be answered only by reference to the earnings *after taxes*. The whole subject of an *excess* profit is hopelessly obscured and befuddled by any other approach." [20]

The following passage from the Ways and Means Committee Report reveals the curious reasons alleged for the change:

> "It seems unfair to allow that part of the income tax which is computed on income which is not subject to the excess-profits tax to reduce the excess-profits net income. . . . The effect of the reversal of the deduction is that the 8 percent credit on invested capital provided in the bill is equivalent to a credit on invested capital of 5.6 percent after deduction of the normal tax and surtax, and the 7 percent credit on invested capital is equivalent to a credit on invested capital of 4.9 percent after deduction of the normal tax and surtax." [21]

To the first of these statements, the obvious answer is that it is unfair to require that excess profits net income be inflated by refusing to permit the prior deduction of all fixed charges against income. The purpose was evidently to get more money regardless of other considerations. The second statement lets the cat out of the bag. It nullifies that part of the Act of 1940 which allows credits of 8 and 7 per cent on invested capital by reducing these percentages to 5.6 and 4.9 per cent respectively. It likewise lessens the attractiveness of the terms on which new investment was to be stimulated. The full significance of this effective reduction in the rates of the excess profits tax credit can only be appreciated by recalling the strong effort that was made to require the use of the invested capital basis by all corporations. The full program evidently involved compulsory use of the invested capital base, and a whittling down of the rates of standard return as computed on this base.

CHAIRMAN PARKER: We all thank Dr. Lutz.

Our next speaker is Mr. Randolph E. Paul, who I think you all know from his excellent books, especially that one on the Law of Federal Income Taxation.

[20] *Hearings before the Committee on Finance on H. R. 5417*, Pt. 2, p. 1204.

[21] *Loc. cit.*, p. 24.

SUGGESTED INCOME TAX REVISIONS

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The program for defense spending has now soared beyond the mark of $60,000,000,000. This is considerably more than the value of all building construction in the United States since 1927. It is twice as much as the total investment in American railroads. It is twice as much as the total value of all passenger automobiles produced in this country during the past fourteen years.[1] And there is every indication that the program has not yet reached its peak.

Mr. Morgenthau announced in his Chicago speech of October 2, 1941, that our tax structure, as modified by the recently enacted 1941 act, will yield about $14,000,000,000 in revenue; he added his opinion that "it still contains many inequalities and many omissions which will have to be corrected next year." When taxes reach such startling proportions, the problem of fair distribution[2] becomes highly acute. On the one hand, a burden escaped by some taxpayers and passed to other taxpayers becomes intolerable, and on the other hand, the effect of hard provisions becomes disastrous for taxpayers. Our revenue system, founded as it is so largely upon the principle of self-assessment, needs the cooperation of taxpayers.[3] Indeed, one may put the matter in the strongest possible terms by saying that our tax system simply will not work in the emergency if it breeds widespread dissatisfaction and resentment. This will most certainly happen if the tax structure does not distribute its enormous burden equitably among taxpayers. The people are willing to pay taxes, but they are unwilling to see some people avoid taxes.

We have also an important policy problem. For years our economy has been running well under capacity. National income reached a low of $40,000,000,000 in 1932. All this is now reversed. Defense has given a blood transfusion to the economy. For 1940 our national income was $76,000,000,000; in 1941 it will probably be in the neighborhood of $87,000,000,000. It has been estimated that national income in 1942 may be 10 to 15 percent higher than in 1941. There was plenty of reason for a deficit in the lean thirties, but what reason is left today? The ugly question must be faced: If a nation cannot balance its budget when it has reached the peak of its productive capacity through the utilization of its manpower and facilities, when can it balance its budget? Mr. Eccles, Chairman of the Board of Governors of the Federal Reserve System, while admitting that the

[1] Morgenthau, Address delivered in Chicago, October 2, 1941.

[2] Cf. Frankfurter, *Mr. Justice Holmes and the Supreme Court*, p. 42 (1938).

[3] Gaskill, "Preserving a Willing Attitude among Taxpayers," 16 *Tax Mag.* 649 (1938).

drastic tax necessary for balance would be politically impossible at this time, has urgently suggested the need of greater effort in this connection.[4] And the cognate question may be added, why should our tax system not recapture for the government a large part of the defense expenditures it is making.[5] Are we going to allow a part of our population to make an inordinate profit out of war? The President has repeatedly answered this question in the negative, but so far his policy remains unfulfilled.

Taxes also enter into the highly complicated problem of inflation, whatever that word means.[6] The threat of inflation is a dark shadow across the immediate future, and taxes are a principal instrumentality of prevention, for, in the language of Mr. Eccles, they will " reduce consumer demand for goods where the supply is inadequate." [7] Here taxes have a function which may be even more vital than revenue production. The good effect of increased governmental revenue will be more than neutralized if the government must spend in a boom market, and the public will lose the benefit of an amplified national income if the purchasing power of that income is reduced in greater effect than the increase of income. Furthermore, inflation is a bubble, which like all bubbles eventually bursts.[8] Mr. Morgenthau's point cannot be too strongly emphasized that every citizen has a " personal stake " in the prevention of the chaos of inflation.

Mr. Morgenthau promised the bankers assembled in Chicago a genuinely " all-out " tax bill in 1942, to be levied " upon all in accordance with their ability to pay." Of course, no one outside intimate governmental circles knows Mr. Morgenthau's exact plans, and I suspect that his mind is far from closed to what may be revealed by further study of the immense problem before him. He was undoubtedly intending to state policy in the broadest terms, leaving details to the future. But the situation calls in the end for a bill of particulars, and I would like to suggest some points of an increased tax program for your consideration in the months to come when the Treasury's " all-out " tax bill is in the process of gestation. I have to do so in more or less categorical fashion, for you would not have time to listen to a detailed discussion of the reasons for and against each proposed change. Indeed, the subject is so vast that I cannot even list the host of technical amendments our income tax statute demands if it is to be put in condition to endure the strain

[4] Testimony before the Committee on Banking and Currency, House of Representatives, 77th Cong., 1st Sess., September 29, 1941.

[5] Eccles, " Price Fixing Is Not Enough," 24 *Fortune*, No. 2 (1941).

[6] See Chase, *The Tyranny of Words*, p. 291 (1938).

[7] Eccles, " Price Fixing Is Not Enough," 24 *Fortune*, No. 2 (1941).

[8] Cf. Foreword of Mr. Wickard, Secretary of Agriculture, to *Farmers, Farm Prices, and Inflation*, September, 1941.

of an emergency. But if you will permit me to select upon a somewhat mixed basis, I shall now suggest some points of revenue revision that may soon be items of tax history.

1. *Interest on State and Municipal Obligations.*

The subject of the taxation of interest upon the obligations of the states and their political subdivisions was ably discussed yesterday by Mr. Foley, General Counsel of the U. S. Treasury, Mr. Epstein, Solicitor General of New York, and Mr. Seltzer, of the National Bureau of Economic Research. I may, therefore, merely register my opinion as to the necessity of taxing the income from *future* issues of such bonds.[9] For too long we have provided a haven from the sweep of the surtax with the result that a mass of tax-exempt securities is endangering the system of the progressive income tax.[10] I have few doubts as to the constitutionality of taxing the income from future issues of state and municipal bonds.[11] It might be constitutional to tax the interest from *past* issues, but such a step would have many elements of unfairness that may render it inadvisable. The Glass proposal, that the surtax on income from taxable sources should take into account the existence of tax-exempt income, is perhaps too indirect an approach to provide a satisfactory solution.

2. *Capital Gains.*

The maximum rate of capital gain tax has been reduced by the 1941 Revenue Act from 16.5 percent to 15 percent.[12] Possibly this reduction was inadvertent, and we may undoubtedly expect a revision of the capital gain rate to the level of 1940.

But the capital gain and loss situation must, of course, be approached from a larger viewpoint. The subject has always been highly controversial. We have complete variety of opinion on the subject from one extreme, which is against all taxation of capital gains and recognition of capital losses,[13] to the opposite extreme,

[9] This involves the elimination of Section 22(b)(4) of the *Internal Revenue Code.*

[10] Paul, "Redesigning Federal Taxation," 19 *Harv. Bus. Rev.* 143, 146 (1941).

[11] See Department of Justice Study entitled *Taxation of Government Bondholders and Employees*, pp. 21, 43 (1938). Cf. Chandler, *The Case for the Municipalities against Federal Taxation of Municipal Securities*, address delivered before the American Bar Association, September 30, 1941.

[12] Section 117 of the *Internal Revenue Code* remains unchanged by the 1941 Act. Section 101 of the 1941 Act at the same time integrated the defense tax into the surtax rates. Section 15 of the Code, imposing the defense tax, was entirely revamped and no longer deals with the defense tax.

[13] Nelson, "The Question of Taxing Capital Gains, The Case against Taxation," 7 *Law & Contemp. Prob.* 208 (1940); 2 May, *Twenty-five Years of Accounting Responsibility*, p. 144 (1936).

which thinks that no differentiation at all should be made between capital gains and ordinary income.[14] Without going the full length in either direction one may at least point out that the present capital gain rate is the most favorable in our income tax history. The capital gain rate in the 20's was 12.5 percent, but we ended this period with a highest surtax bracket of 20 percent. At this time the capital gain rate was, therefore, five-eighths of our top surtax bracket. This relative position of the capital gain rate should be compared with a relationship of a rate of 15 percent to 77 percent. The fraction mentioned has dropped from five-eighths to one-fifth.

Whatever may be the answer to the capital gains problem, it seems clear that the present relationship of the capital gain rate to the surtax brackets involves an inexcusable discrimination against individuals who derive their income from personal services and sources other than capital gains. The capital gain rate should, therefore, be substantially increased. Perhaps we should go back to the flexible rule established by the 1934 act, which at least recognized the period of accrual of capital gains in a more refined way than does the present act. At the very least, the tax on capital gains should, in deference to the principle of ability to pay, take into account other non-capital gain income of the taxpayer. An increase in capital gain rates should perhaps be accompanied by a longer loss carry-over.

3. *Pension Trusts.*

Pension trusts in their many variations are a growing menace to governmental revenue. The institution of pension trusts has in its favor many of the arguments put forward on behalf of social security. But in practice the deferment of tax granted in the case of pension trusts[15] is being grossly abused by the establishment of trusts in favor of high salaried key employees and stockholders.[16] Some limiting provisions should be placed in the revenue act to make the pension trust exemption applicable only in the case of *bona fide* trusts with a valid *social,* as distinguished from a *tax-avoiding,* purpose. The underlying legislative purpose should not

[14] Simons, *Personal Income Taxation,* p. 148 (1938); Kent, "The Question of Taxing Capital Gains, The Case for Taxation," 7 *Law & Contemp. Prob.* 194 (1940). On this subject see also Haig, "Taxation of Capital Gains," *Wall Street Journal,* March 23, 25, 29, April 2, 8, 13, 1937; Blough and Hewett, "Capital Gains," contained in *Studies in Income and Wealth,* vol. 2, p. 191 (New York, National Bureau of Economic Research, 1938); Colm, "The Revenue Act of 1938," 5 *Social Research* 255 (1938).

[15] *I.R.C.,* Secs. 23(p), 165.

[16] See Altman, "Pension Trusts for Key Men," 15 *Tax Mag.* 324 (1937); Paul, "The Background of the Revenue Act of 1937, 5 *U. of Chi. L. R.* 41, 77 (1937); *Hearings before the Joint Committee on Tax Evasion and Avoidance,* 75th Cong., 1st Sess., p. 294.

be lost sight of in any further consideration of this problem, because some taxpayers have abused the pension trust provision. Innocent beneficiaries should not be punished with the guilty when amendments will serve to draw a line between those who deserve a postponement of the tax and those for whom the benefits of tax postponement can hardly have been intended. This is an example of a problem constantly faced in revenue legislation. One must find a way of reaching particular cases of avoidance without striking, like Herod's massacre, indiscriminately at all cases irrespective of deserts.[17]

4. *The Interest Deduction.*

The interest deduction now allowable[18] for all interest paid or accrued, except interest on indebtedness incurred or continued to purchase tax-exempt securities, unduly encourages corporate financing by *borrowing* rather than by *capital contributions*. The difference between many preferred stock and bond issues is often more legalistic than real; yet the corporation issuing the stock does not have the interest deduction allowed to the corporation issuing bonds. Every tax practitioner is familiar with the process of converting stock issues into bond issues in order to reduce taxes.[19] Some limitation should be placed on the interest deduction not only to raise revenue, but also to put equity financing upon a reasonable parity with financing on a less sound business basis.

5. *Percentage Depletion.*

No statement of possible income tax changes would be complete without a reference to percentage depletion. Oil and mining companies are granted a special depletion deduction, consisting of a percentage of gross income from depletable property limited to a percentage of the net income from the same property.[20] This depletion allowance is optionally greater than the ordinary allowances for loss of wasting assets; it is not restricted to a recovery of cost or value at March 1, 1913, of the producing property; and it goes on as long as production continues without relation to the recovery of cost or value at March 1, 1913. The elimination of the deduction was recommended as long ago as 1933 by the Secretary of Treasury.[21] In 1937 the President recommended the elimination of per-

[17] Cf. Paul, *Studies in Federal Taxation*, p. 65 (1937).

[18] *I.R.C.*, Sec. 23(b).

[19] We cannot discuss today the question whether such reorganizations or recapitalizations have the benefit of the statutory exemption. Cf. Paul, *Studies in Federal Taxation*, Third Series, p. 121 (1940).

[20] *I.R.C.*, Secs. 23(m), 114(b)(3)(4).

[21] Testimony of Under Secretary Magill, *Hearings before the Joint Committee on Tax Evasion and Avoidance*, 75th Cong., 1st Sess., p. 33 (1937).

centage depletion.[22] Congress has failed to act on this recommendation, but the existence of the emergency may possibly change legislative attitudes.

6. *Joint Returns.*

The subject of joint returns for husband and wife has received much publicity in the last few months. Much of this publicity, with its emphasis upon constitutional and moral aspects of the problem and its effect upon the institution of marriage and women's rights, has established a new record for irrelevance. Professor Griswold, who has stated the arguments against the proposal in the strongest possible way, has admitted the speciousness of these arguments,[23] stating that "he who puts his trust in unconstitutionality today in matters of this sort seems to disclose a rather surprising unawareness of the happenings of the past few years." As to moral grounds, Professor Griswold calls attention to A. P. Herbert's chapter "Rex v. Pratt and Merry—The Tax on Virtue" in his "Uncommon Law," and says that it would be hard to show that the British institution of marriage has been impaired by the long-standing practice of requiring joint returns. Along with my partner, Mr. Harry Rudick,[24] I venture to suggest a reconsideration of this whole problem for purposes of an "all-out" revenue act, for the following reasons:

(a) There seems to be no politically practicable method other than joint returns of eliminating the unfair advantage enjoyed by residents of the community property states.[25] Obviously there is no sound foundation for a rule that makes the federal income tax depend upon where the taxpayer lives, and which requires a married couple living in New York, for example, to pay a much higher tax than a married couple living in California.

(b) There is no convincing reason for a tax disparity between a family in which the husband is the sole source of income and a family in which the wife contributes to the family economic unit.

[22] Letter of President Roosevelt dated June 1, 1937, quoted in *Report of the Joint Committee on Tax Evasion and Avoidance*, 75th Cong., 1st Sess., p. 1 (1937).

[23] Griswold, Letter published in *New York Times*, July 27, 1941.

[24] See letter of Mr. Harry Rudick to Chairman Doughton of the Ways and Means Committee, July 17, 1941, reprinted in the *Congressional Record*, vol. 87, No. 139, p. 6618 (1941). See also Rudick, "The Problem of Personal Income Tax Avoidance," 7 *Law & Contemp. Prob.* 243, 252-3, 264 (1940), where Mr. Rudick advocates that joint returns cover not only spouses, but also minor children. Cf. Shoup, "Married Couples Compared with Single Persons under the Income Tax," 25 *National Tax Assn. Bulletin*, No. 5, pp. 130-135.

[25] I have discussed the community problem at length in forthcoming volumes (Sec. 1.09) on estate and gift taxation, to be published by Little, Brown & Company.

The family, generally speaking, will spend approximately the same amount for rent, food, support of children, etc., whether its income stems entirely from the husband or derives in part from the wife. The income tax should recognize these basic economic realities.

(c) In the vast majority of families in the United States practically all the family income is earned by the husband. If joint returns are not required, the families of this vast majority will have to pay a higher tax than the families in the minority group. Recently increased rate brackets make this discrimination all the more unworthy of continuance.

AMENDMENTS TO ELIMINATE HARDSHIP

At a time when we are considering amendments of the statute designed to eliminate discriminations, it is certainly not out of order to consider changes which may reduce revenue. We can be intelligently generous; we need not raise our revenue by the hardship method. Several changes of this sort are dictated by considerations of equity. The provision of the last Senate bill, allowing the deduction of expenses incurred in conserving and conducting business affairs, should be passed.[26] With rates at their present level a limited deduction for medical expenses would be no more than a reasonable concession to taxpayers. The same is true of the credit for dependents, which now stops when the dependent reaches the age of 18 years, unless the dependent is physically or mentally incapable of self-support.[27] It need hardly be argued that many dependents are at the peak of their dependency immediately after the age of 18 years. The treatment of alimony has been a sore spot in our tax system for many years,[28] and the provision inserted in the last Senate bill [29] taxing alimony to the wife should be enacted. The law surrounding the status of mortgage foreclosure transactions should certainly be clarified.[30] We could no doubt afford to legislate away some of the hardship caused by the Supreme Court decision in *Helvering* v. *Bruun*;[31] at least we might arrange for some postponement of payment where so much non-liquid income is precipitated in the hands of a lessor by the termination, cancellation or forfeiture of a lease.

26 Senate Bill, 1941 Act, Sec. 119. See Conf. Report, H. Report No. 1203, 77th Cong., 1st Sess., p. 12.

27 *I.R.C.*, Sec. 25(b)(2).

28 See Paul, "Five Years with Douglas v. Willcuts," 53 *Harv. L. R.* 1 (1939).

29 Senate Bill, 1941 Act, Sec. 117; Sen. Finance Comm. *Report No. 673*, 77th Cong., 1st Sess., p. 11.

30 See *Helvering* v. *Hammel*, 311 U. S. 504 (1941); *Electro-Chemical Engraving Co., Inc.* v. *Comm.*, 311 U. S. 513 (1941). See also Paul, *Studies in Federal Taxation*, Third Series, p. 296 (1940).

31 309 U. S. 461 (1940).

There is real need for relief from the hardships latent in Section 42 of the Internal Revenue Code, especially when the income tax rates have been so sharply increased. The possibilities of unfairness have been accentuated by the Supreme Court's decision in *Helvering* v. *Enright*[32] that a partner's share of partnership fees accrues at the date of death even though partner and partnership have filed returns on the cash basis. Lawyers will sometimes be flattered at the high estimates which the bureau places on the value of their unfinished legal services under this doctrine. It would seem more fair to provide, however, that regardless of accrual for estate tax purposes, the recipient of the income should have the privilege of reporting the income as taxable when received. Any such provision should apply equally to accrued income arising from personal services or any other type of accrued income.[33] Consistency would require an amendment to Section 43 eliminating from the decedent's final return any accrued deduction in the event that the decedent's estate availed itself of the option to report income when and as received. The underlying purpose of Section 42—that no income should escape tax—could thus be accomplished without the gross inequity of throwing several years' income into one return. Perhaps at the same time the estate should be required to report the income on the same basis—cash or accrual—as the decedent used prior to death, and perhaps it should also be required to use the same accounting period.[34]

FURTHER QUESTIONS FOR CONSIDERATION

The foregoing suggestion are not intended to be all inclusive. Many possible amendments of the statute should be canvassed in order to determine whether changes are advisable.[35] It is a serious

[32] 312 U. S. 636 (1941). See also *Pfaff* v. *Comm.*, 312 U. S. 646 (1941).

[33] An amendment to this provision might be framed along the lines of the provisions of Section 44(d), relating to the transmission of installment obligations at death. In order to protect the revenue, the government might be empowered to require the filing of a bond as is required under Section 44(d).

[34] Cf. *Estate of Cyrus H. K. Curtis*, 36 BTA 899.

[35] Two clearly advisable amendments may be mentioned in a footnote. The statute has a flagrant defect in its provision permitting value at date of death as a basis even in cases in which an executor has elected under Section 811(j) of the Internal Revenue Code to report assets of the estate at their value a year after the death of the decedent. To illustrate the point: A decedent may leave assets having a value of $1,000,000 at the date of his death which a year after death have dropped in value to $500,000. In such a case an executor paying estate tax on only $500,000 secures a basis of $1,000,000. Obviously the statute should insert a new subdivision in Section 113 to the effect that where the optional valuation privilege is exercised, the basis of property shall be the value as used in the estate tax return.

question whether we should allow the basis of value at the date of death for the purpose of determining gain or loss on the sale or exchange of property transmitted at death. Our system of taxing nonresident alien individuals and foreign corporations involves a marked discrimination in their favor.[36] It should not be taken for granted that we ought to allow as a deduction non-business casualty losses,[37] non-business interest,[38] non-business bad debts,[39] and non-business taxes.[40] For example, the deduction for taxes on residential property could well be eliminated. It is well worth consideration whether we should return to the principle of consolidated returns in the case of affiliated corporations. The problem of intercorporate dividends is far from solved.[41] Perhaps we should frankly admit the impossibility of preventing the avoidance of the regular surtax on gains from preferred stock redemptions, and apply the capital gain rate to such redemptions.[42] The Chandler Act in its relationship to the basis provision should again be revised.[43] Dividends on fully paid-up life insurance or endowment policies should be taxable, as proposed in 1938, regardless of whether the consideration paid has been recovered. Finally, without attempting to exhaust the list, one may recall the perennial inadequacy of Section 102.[44] For years corporate taxpayers have successfully argued that they may pile up surpluses for the mythical rainy day of the unpredictable future, or that they may in the same sort of future go into

In the case of contributions in the form of property the law now permits deduction to the extent of the value of the property transferred at the date of the gift. Thus, where a taxpayer has transferred securities costing $1,000, but having a value at the date of the gift of $5,000, he is allowed a deduction of the latter amount without any tax on the appreciation in value of $4,000. Although the donor may have received income under the doctrine of vicarious satisfaction established by *Helvering* v. *Horst*, 311 U. S. 112 (1940), some provision should be inserted in the statute to settle this question. A possible provision would be to allow a deduction only in the amount of the adjusted cost basis of the property to the donor or its value at the date of the gift, whichever is lower.

36 This discrimination was only partly corrected in 1937. See Paul, "The Background of the Revenue Act of 1937," 5 *U. of Chi. L. R.* 41, 86-7 (1937).

37 *I.R.C.*, Sec. 23(e)(3).

38 *I.R.C.*, Sec. 23(b).

39 *I.R.C.*, Sec. 23(k).

40 *I.R.C.*, Sec. 23(c).

41 *I.R.C.*, Sec. 26(b).

42 Cf. *John D. McKee*, 35 BTA 239.

43 See Paul, "Debt and Basis Reduction under the Chandler Act," 15 *Tulane L. R.* 1 (1940).

44 Rudick, "Section 102 and Personal Holding Company Provisions of the Internal Revenue Code," 49 *Yale L. J.* 171 (1939).

a new business in the manner of the White Knight, who kept a bee-hive on his horse because he might someday wish to keep bees.[45] Both of these arguments have acquired new vitality in the uncertainty of our post-war future.

THE EXCESS PROFITS TAX

I have left for the end the controversial excess profits tax, and I shall leave most of that subject to tomorrow morning's session. But since the excess profits tax is a corporate income tax, it is relevant to mention the subject in this session under the heading "Evaluation and Suggested Revision in View of Present and Prospective Needs."

The excess profits tax, as it is now constituted, is designed to recapture a part of the excess profits of the emergency. It is not intended to take any part of what might be called ordinary excess profits not attributable to the present emergency. In this respect the tax seems to me to go on the false premise that it is possible ever to make a clear-cut differentiation between emergency profits and non-emergency profits. No one can tell what part of the profits of any particular concern in 1941 are attributable to the emergency and what part of such profits are the natural culmination of previous years of effort. The tax should discard this ephemeral distinction and frankly exact a contribution from corporate profits not attributable to the emergency, as well as corporate profits which are undoubtedly the result of governmental defense expenditures.

It will be unhealthy for all of us if the large corporations, which are being given the bulk of the emergency orders, are permitted to keep for their own such a share of emergency profits that small business is put at a further disadvantage. Corporations as well as individuals must carry their part of the load, and a stiffer excess profits tax than we now have is essential for that purpose. For the theory of that tax I go along with Mr. Eccles in the belief that we should return to the original scheme of the Treasury, making a flexible invested capital determinative of the exemption of excess profits. That formula provided an exemption from the tax, dependent upon the previous earnings of the corporation, of at least 5 percent and at most 10 percent of the invested capital.[46] Such a formula serves the double function of recapturing emergency profits and of collecting a share of defense cost from corporations which were highly prosperous in the depression period. The income credit in the present

[45] Paul, "Redesigning Federal Taxation," 19 *Harv. Bus. Rev.* 143, 145 (1941).

[46] H. R. *Rep. No. 2894*, 76th Cong., 3d Sess., pp. 4, 22 (CB 1940-2, pp. 498, 512). The floor percentage recommended by the subcommittee was 4 per cent. *Hearings before Ways and Means Committee and Finance Committee on Excess Profits Taxation*, 76th Cong., 3d Sess., pp. 4, 12 (1940).

bill[47] gives an undue advantage to corporations with established records, and puts new corporations and corporations without high depression earnings at an undue disadvantage. If the income credit is retained, it might be subordinated in importance by making the excess profits tax consist of one-half of the tax computed on the basis of the income credit plus one-half of the tax computed on the basis of invested capital.

With all my belief in the principle of the excess profits tax, as compared with the crude instrumentality of the straight corporate income tax, I must confess to misgivings as to the treatment of concerns in which capital is a relatively minor income-producing factor. We may as well admit that we are far from a solution of this problem. The personal service corporation provision[48] does not afford a complete solution; neither do the so-called relief provisions.[49] I cannot but feel that there is some solution of this problem which we have all missed. Perhaps we could optionally exempt from the tax certain types of corporations on the condition that they would accept some fair substitute tax.

A final word may be said with respect to the much advertised difficulty of computing invested capital. On this point one hears much defeatism. In view of better records and a more efficient Treasury personnel, the job is relatively easy compared with what it was in 1917 and 1918, particularly with the adoption of the unadjusted basis for loss as the measure of the inclusion in invested capital of property paid for with stock. Invested capital is not the esoteric concept many try to make it appear to be. It is simply the capital, surplus, and undivided profits, or net worth of the corporation without taking into account any unrealized appreciation or depreciation in value of assets. It is true that stock dividends, liquidations, and reorganizations raise problems, but they are far from insuperable. We could afford a little greater degree of optimism about the possibility of computing invested capital.

CONCLUSION

There will be some who think some or all of the proposals made in this paper are drastic and even confiscatory.[50] The answer is, first, that times are extraordinary. The old formulae of postponement and evasion are inadequate in the face of three imperative necessities, (1) unprecedented demands for revenue, (2) the control of price inflation, and (3) the elimination of profit from war. It would be fatuous at such a time to soft-pedal our policy. And it

[47] *I.R.C.*, Sec. 713.

[48] *I.R.C.*, Sec. 725.

[49] *I.R.C.*, Secs. 721, 722, 723.

[50] Cf. Lawrence, "High Court 'Captured' in Tax Cases," *The Evening Star*, Washington, D. C., October 9, 1940.

may be an expensive luxury to neglect the thorough-going reconstruction job so sorely needed by our revenue system. Tomorrow may be too late.

CHAIRMAN PARKER: I know we all thank Mr. Paul for his fine talk about all these problems, adjustments which might be made to the income tax.

I think my watch is right. It is ten minutes to five. There was to be a discussion. I believe they wish to use the room at five o'clock.

W. R. BRADLEY (South Carolina): I have listened with a great deal of interest to what has been said. Being an administrator of taxes, income taxes, I think that the administration at Washington could be bettered considerably by allowing the revenue agents and the collectors in the various collecting districts to handle not only the 1040-A's—that is, the small returns, but also the 1040's.

I think that Washington ought to allow the collectors and the revenue agents to handle all corporations that have a capitalization under $100,000. As it is, any question that comes up on a 1040 or on a corporate return, the taxpayer must go to Washington and plead his case there, and when he crosses the Potomac River or enters the confines of the District of Columbia, he feels like he is crossing the Bridge of Sighs, or climbing the steps of a gallows, with his expert by his side. It costs him to leave his home, it costs him in Washington, and it costs him to hire the expert to help him out.

If these smaller returns were left with the collectors and the revenue agents, they could handle them just as well as they handle them in Washington, because the fellows in Washington who are handling those things come from the states, and there is no trouble about winding up those things in the districts. It would be a great advantage to the taxpayers in the various states to be able to go to the man he knew, up to his collector or his revenue agent, with whom he is acquainted, and the revenue agent knows the situation better than Washington does—he knows the individual and he knows his circumstances; he is better qualified and better fitted to handle that question than Washington is.

Another thing: I think that the federal government should take the taxpayer more into its confidence. A revenue agent who goes to his taxpayer and goes through his books, looks into his depreciation schedules and his losses, and comes to his conclusions, then folds his portfolio and slips out without ever telling the taxpayer what he has done or what he expects to report, is a bad idea. I think he ought to take the taxpayer into his confidence, and it would result in better feeling and a better attitude between the government and the taxpayer. If the thing goes on as it is, there is going to be a

reverse some of these days. Old Man People will stand a lot, but if Old Man People becomes aroused, why, he is going to overturn some things. I think that the government ought to take that into consideration.

In the administration of the state income tax in South Carolina, I advise all of my agents to take the taxpayer into his confidence, and to tell him what he has found there that he considers erroneous in his return, and to tell him whatever disallowances he expects to make, so the taxpayer will know what he may expect in the report that he reaches.

I wish the government would consider those things and make it a little easy. It will become more popular. As it is, a lot of them are afraid to go to Washington.

Chairman Parker: Thank you, Mr. Bradley.

I believe it was the desire of the federal government to do a lot along decentralization lines. How far that has worked out in our districts, I don't know, but it was an announced policy, wasn't it, Dr. Blough?

Mr. Blough: It has been done throughout the country, as I understand it.

Chairman Parker: Are there any other questions? If there are no other questions, I believe the meeting had better stand adjourned.

(The meeting thereupon adjourned, at 7:55 o'clock.)

ELEVENTH SESSION

TUESDAY, OCTOBER 14, 2:30 P. M.

Murphy Hall Auditorium
University of Minnesota

ROUND TABLE CONFERENCE

Louis M. Nims, presiding.

CHAIRMAN NIMS: As you well know, this meeting is given over to the discussion of State Sales and Use Taxes. Each is spoken of as a new form of taxation; having come into importance within the past ten years when the depression had rocked other tax bases.

The purpose of the meeting is not to argue the merits of de-merits of these two taxes. It is expected that the capable speakers upon whom I am about to call, together with the informal discussion that will follow, will better inform us of the part these two taxes play in the collection of approximately seven billion dollars of state revenue. What attitude does the United States Supreme Court and other courts take toward these new forms of taxes and especially the use tax; information should be forthcoming for answer to the question—do use taxes erect or create state trade barriers. Last, but not least, these expert researchers and experiencd tax administrators should stress good administrative practices to the end that we better understand the phrase—uniform tax administration.

The attention of the selected speakers and discussion speakers is called to the rules and regulations of this conference. Briefly stated, such rules are as follows: Each speaker should be limited to twenty minutes for presentation of a formal paper. He shall be warned two minutes before the expiration of such period; in general discussion, each speaker shall be limited to seven minutes and no person shall speak more than once during the same period of discussion until others desiring to speak have been given the opportunity to do so.

I take pleasure in presenting Robert C. Brown, Professor of Law, University of Indiana. His subject is States Sales and Use Taxes.

STATE SALES AND USE TAXES

ROBERT C. BROWN
Professor of Law, University of Indiana

Outside of the federal field—and it has its possibilities there too—there has been no more striking tax phenomenon in the past few years than the development of sales and use taxes. These are not

wholly new, but their tremendous development in scope and importance came within the last decade. With the tendency of the states to withdraw largely from the property tax field in favor of the local subdivisions, the state sales tax, with the supplement of the use tax, has become one of the largest sources of revenue; and comparatively few are the states which are not now making increasing use of this expedient. It may indeed be added that several of our larger municipalities are embarking more or less upon the same course.

The present paper is an attempt to consider the more important legal problems which are presented by these taxes. The economic problems must be largely left to those more qualified. However, it is impossible to entirely disregard the most important economic argument which has been made against these taxes — namely, that they are regressive or, to use more colloquial language, that they are poor man's taxes. By this is meant that the tax burden is upon the consumer, and that since the rich man does not consume an amount greater in proportion to his riches, the poor man bears more than his fair share of the total tax burden.

This argument obviously rests heavily upon the assumption that the sales tax is fully passed on by the seller, who formally pays it, to the consumer. Here we need only consider the sales tax itself, since the use tax, as will presently appear, was at least originally conceived of merely as a supplement to the sales tax for the purpose of preventing its avoidance in circumstances where evasion was otherwise possible. Even so, the validity of the assumption that a sales tax is passed on has been challenged by several authorities.[1] It is certainly true that under unusual circumstances even a sales tax imposed by a statute which requires it to be passed on will not always be entirely escaped by the seller.[2]

But on the whole it seems probable that the bulk of the tax burden is borne by the consumer in normal circumstances, and therefore the argument of regressiveness is of some weight. On the other hand, this disadvantage is minimized, if not entirely wiped out, by a selective sales tax, since then the tax can be imposed only with respect to commodities not ordinarily purchased by persons of moderate means. Furthermore, the undoubted regressive effect of a general sales tax is minimized by the use of other taxes falling more heavily upon persons of large resources, notably the net income tax. At any rate, the enormous productivity of the sales tax, even in periods of comparative financial stress, is likely to insure not merely its maintenance, but its continual extension. Nor, so far as one can

[1] See Warren & Schlesinger, "Sales and Use Taxes: Interstate Commerce Pays its Way," (1938) 38 *Col. L. Rev.* 49. See also, Pierce, "The Place of Consumers' Excises in the Tax System," (1941) 8 *Law & Contemporary Problems*, 430.

[2] See *New York* v. *Feiring*, 61 S. Ct. 1028 (1941).

see, will war conditions affect other than favorably upon the employment of this tax.

Apart from purpose of interstate commerce and trade barriers, which will be considered hereafter, there appear to be no serious legal difficulties in the way of this tax. Since it is an excise tax, the strictest equality and uniformity provisions of state constitutions do not generally affect it. To be sure, the federal Supreme Court decided a few years ago in *Stewart Dry Goods Co.* v. *Lewis*[3] that a sales tax cannot be imposed at a graduated rate—that is, that it cannot be increased in rate as the amount of sales by the particular seller increase.

This decision was by only a six to three vote, and there is no great probability that it would be adhered to by the present court. In fact it seems quite doubtful in principle. It is true that if the tax is fully passed on there seems no reason why a person should pay more because he has bought from a larger store. But a graduated tax would probably be more difficult to pass on, and the higher rates would, it seems, be borne at least in part by the larger stores as overhead. It is true also that a graduated sales tax is more objectionable than a graduated net income tax, but the Kentucky law invalidated in the *Stewart* case had a maximum rate of 1 per cent, which because of the lower brackets could never be fully reached. The invalidation of a sales tax on the basis of this very slight measure of graduation seems unjustified, and the dissenting opinion by Mr. Justice Cardozo quite unanswerable.

But even if this doctrine is adhered to, there seems no reason to think that the utility or progress of the sales tax will be much hampered. While it seems unwise to deprive the taxing authorities of the right to make some small measure of graduation of rates if deemed desirable, yet graduation of sales taxes was not used much before the *Stewart* case, and it is undoubtedly possible to impose an effective and productive sales tax at a uniform rate.

USE TAXES

The use tax has made an even more recent but almost equally spectacular entrance upon the stage. It is clearly a tax imposed upon the consumer, so that no problem of passing on is involved. Presumably such restrictions as there are on sales taxes, such as the possible prohibition of a graduated rate, apply to use taxes also; but graduation is still less needed here.

The close connection between sales and use taxes appears from the fact that the latter were originally intended only to supplement sales taxes. For many years it was, or was supposed to be, the law that a sales tax could not be imposed directly by any state upon interstate commerce transactions, on the ground that this was a

[3] 294 U. S. 550 (1935).

prohibited regulation of interstate commerce.[4] This rule was increasingly limited to the courts,[5] but it could never be entirely escaped. The use tax was originally imposed upon the consumers in sales tax states who bought goods in interstate commerce, thereby escaping the sales tax. The rate of the use tax was usually equal to that of the sales tax, and the obvious intent, and the substantial result, was to equalize the burden, and thereby protect both the state revenues and the local merchants. It was upon this general theory that the use tax was originally justified.[6]

However, this particular justification has departed with the ending of the restriction on the state taxing power which the tax was intended to escape. The decision last year of the federal Supreme Court in *McGoldrick* v. *Berwind-White Coal Mining Co.*[7] substantially overruled the previous restrictive authorities, by holding that the jurisdiction of the purchaser may impose a sales tax with respect to goods even necessarily purchased in interstate commerce.

This decision, regarded as rather revolutionary, does not, on analysis, seem actually so. It merely gave the death blow to a doctrine which, while insistently stated, was actually already moribund. The whole doctrine had been more and more closely confined by exceptions,[8] but even where it definitely applied, there were rather simple expedients for depriving it of nearly all effect.

In the first place, there was the doctrine of *American Manufacturing Co.* v. *St. Louis*,[9] that a license tax could be imposed upon a local manufacturer measured by goods sold, even though these sales were exclusively in interstate commerce. The theory was that this tax was not a tax upon interstate commerce but rather upon the local manufacturing business. But the difference in terminology and theory does not change the fact that the burden is, or may be made, precisely the same as a tax upon the sale. The verbal distinction which the court insisted upon between measure and subject is a beautiful example of one without a substantial difference.[10]

[4] See for a discussion of the earlier authorities, Lowndes, "State Taxation of Interstate Sales," (1935) 7 *Miss. L. J.* 223.

[5] As, for example, in *Wiloil Corp. v. Pa.*, 294 U. S. 169 (1935), where it was held that a state might tax a sale to a purchaser in that state, though the transaction actually involved an interstate shipment, but the product could have been procured in the state.

[6] See *Mann* v. *McCarroll*, 198 Ark. 628, 130 S. W. (2d) 721 (1939).

[7] 309 U. S. 33 (1940). The case involved the sale of anthracite coal by a producer in Pennsylvania (in which state all U. S. anthracite is produced) to a New York City purchaser. The New York City sales tax was held to be properly imposed upon this transaction.

[8] See *Wiloil Corp.* v. *Pa.*, *supra*, note 5.

[9] 250 U. S. 459 (1919).

[10] There are numerous other cases applying this doctrine, sometimes under rather extreme circumstances. Typical of these are *Hope Gas Co.* v. *Hall*, 274 U. S. 284 (1927) and *Utah Power & L. Co.* v. *Pfost*, 286 U. S. 165 (1932).

But if this were not enough, the use tax itself, which was sustained by the federal Supreme Court,[11] enabled the states to entirely avoid the unfortunate effect of the old rule. If the state is prohibited from taxing the sale but can impose the same tax directly upon the consumer simply by calling it a use tax, the state is no worse, and the consumer is certainly no better off, at least so far as the use tax is as effectively collectible as the sales tax, a problem which will be considered later. The use tax cases have therefore settled the economic issue and the *Berwind-White* case merely sensibly recognized the fact.[12] It is to be noted, however, that this frank subjection of interstate transactions to state sales taxes has removed the original justification for use taxes, and if they are to be continued, some other reason for them must be found.

THE TRADE BARRIER ASPECT

Before considering what the states ought to do with respect to this problem, it is important to consider whether the present situation is satisfactory from the standpoint of the national interest, and more particularly from the standpoint of the possibility of trade barriers. Notice that not much emphasis is now laid upon the problem of interstate commerce. The *Berwind-White* case[13] has seemed to remove any necessity of discussing that problem in this connection. We seem to be approaching, if we have not already reached, that paradise where everything is interstate commerce for purposes of federal regulation (especially labor regulation) and nothing is interstate commerce so far as state taxing power is concerned. But if this new dispensation is leading us into serious trade barriers, we should certainly watch out step.

Until recently one would have supposed it unnecessary to argue this point. But the idea has risen in some quarters that trade barriers between states are innocuous or even desirable. To this it should be sufficient to say that the fundamental reason for the adoption of our original constitution was to do away with existing trade barriers, and thereby to have a national economy. If this is considered too antiquated a theory to be advanced at present, it still seems reasonable to say that present events abroad do not indicate any great desirability of splitting up this country into separate small economic units, with no communication other than political.

A more subtle way of excusing trade barriers is to say that it is a problem for Congress, and that the courts should not interfere.

[11] *Henneford* v. *Silas Mason Co.*, 300 U. S. 577 (1937).

[12] See Powell, "New Light on Gross Receipts Taxes," (1940) 53 *Harv. L. Rev.* 909. It has been pointed out that a use tax is a more direct burden upon the consumer than a sales tax, because here he inevitably bears the burden. See the note in (1940) 16 *Ind. L. J.* 260.

[13] *Supra*, note 7.

Indeed, at least one member of the federal Supreme Court seems to have this idea, and one or two others seem to show some favor toward it.[14] But, as already said, this is really nothing but indiscriminate approval of trade barriers. An omniscient Congress with nothing else to do would have its work cut out for it to block in advance all ingenious schemes which the states might concoct for "protecting," as they call it, their local industries from those in other states. And Congress, however nearly it approaches omniscience, still has quite a number of other things to do. Besides all this, if a national court is to resign the responsibility of preventing the states from blocking trade with other states, by taxation or otherwise, it is hard to see what function the court has left, at least so far as the states are concerned.[15] No doubt if the courts will not compel the states to behave, and the states do not behave voluntarily, Congress will interfere; but the interference will almost inevitably be in a manner so crude and harsh as to destroy most of the good and desirable as well as the bad exercises of state taxing power.[16] It will be far better for the states themselves if the courts help them to solve this problem, than if it is left to Congress.

Of course taxes are not the only trade barriers. Nor are sales and use taxes inevitably the worst trade barriers. Indeed such chain store taxes as have been imposed in some states, notably Louisiana,[17] are probably far worse.

Another concession must be made, and an important one. The doctrine of the *Berwind-White* case does not necessarily involve any trade barriers. If it did, use taxes, at least as applied to interstate transactions, which is their chief purpose, would likewise be objectionable. In both instances there is no penalty for buying goods from an out-of-state seller; the sales tax or the use tax merely equals the tax which would have been imposed if the purchase had been made within the state. In other words, the new doctrine does not necessarily discriminate against interstate commerce, but merely removes a discrimination in favor of interstate commerce. Such is obviously not a trade barrier; indeed it seems clearly desirable.

[14] See Mr. Justice Black dissenting in *Gwin, etc.* v. *Henneford*, 305 U. S. 434 (1939). *McCarroll* v. *Dixie Greyhound Lines*, 309 U. S. 176 (1940) indicates that Justices Frankfurter and Douglas have some favor for this theory.

[15] See Powell, "1939-40 Supreme Court Decisions on State Taxation of Interstate Commerce," (1940) 26 *Bulletin of the National Tax Association*, 23.

[16] See Truitt, "Joint Federal-State Attack Upon Trade Barriers," Chap. XXVIII of the Symposium on *Tax Barriers to Trade*, published by the Tax Institute, Philadelphia, 1941.

[17] Here the tax rate is steeply graduated according to the number of stores wherever situated, whether inside or outside Louisiana. This scheme was sustained in *Gt. A. & P. Tea Co.* v. *Grosjean*, 301 U. S. 412 (1937).

A sales tax imposed solely upon interstate transactions would undoubtedly be a trade barrier, but probably even the present Supreme Court would invalidate it as discriminatory against interstate commerce, unless a substantially similar tax burden was imposed upon intrastate transactions. Similarly, a use tax solely upon goods purchased outside the state would be invalid if it stood alone; but since it generally applies only where the purchase has not been subjected to an equal sales tax, there is no real discrimination and no substantial trade barrier.[18]

On the other hand, if both the state of the seller and the state of the buyer impose a sales tax, the situation is rather different. Here we have two sales taxes to pay if the transaction is in interstate commerce, and but one if the sale is entirely consummated within one state. This is not merely a conceptual burden upon interstate commerce, but it seems to be a substantial trade barrier. Granting that sales taxes are not fully passed on to the consumer, it is submitted that they are passed on to an extent which would seriously discourage interstate transactions and therefore set up substantial trade barriers.[19]

The *Berwind-White* case does not sanction any such double burden. There the tax sustained was imposed by the jurisdiction of the purchaser alone; or at least no sales tax by the state of the producer was shown or even less sustained. However, the same result might perhaps be obtained by an excise tax by the producing state measured by sales, as in the *St. Louis* case [20] previously referred to.

No doubt influenced by these considerations, several commentators have suggested that an interstate sale may be taxed only by the state of the purchaser.[21] As already shown, this seems to be a satisfactory solution, and avoids any serious possibility of trade barriers of this kind. But no authority can apparently be found for this proposition, at least in the federal courts, and there is at least one state decision directly to the contrary. This is the recent case of *O'Kane* v. *State*,[22] decided by the New York Court of Appeals. This sustained a New York stock transfer tax (essentially a sales tax on corporate stock) imposed on sales of stock by New York sellers to out-of-state purchasers. The opinion of the majority relies upon the *Berwind-White* case, and says that a sales tax by the jurisdiction of the purchaser would not result in a multiple burden,

[18] See *Interstate Busses Corp.* v. *Blodgett*, 276 U. S. 245 (1928).

[19] See McNamara, "Jurisdictional and Interstate Commerce Problems in the Imposition of Excises on Sales," (1941) 8 *Law & Contemporary Problems*, 482.

[20] *American Manufacturing Co.* v. *St. Louis*, *supra*, note 9.

[21] See e.g., Vaske, "Are You Selling in Foreign States?", (1941) 19 *Taxes*, 467. Cf. McNamara, *op. cit.*, note 19, *supra*.

[22] 283 N. Y. 439, 28 N. E. (2d) 905 (1940).

since the tax by the purchaser's jurisdiction would be on a different taxable event—namely, the purchase rather than the sale. This is obviously another excursion into pure verbal metaphysics. When one comes down to earth, there has been one event and it has been subject to two taxes. This is a strong inducement to "buy at home," which may be a good slogan sometimes, but is not good constitutional law or practice. It is submitted that this scheme should not be permitted.

The use taxes are often designated as "compensatory" since they normally allow a credit for the amount of sales taxes of the same state paid by the person upon whom the use tax is imposed. But suppose the sales tax has been paid to another state? Then the use tax is certainly not compensatory in any realistic sense, unless a similar allowance is made for the sales tax of such other state, as is not the usual practice.

Of course the problem of the correct verbal characterization of the tax is far less important than the problem whether such a use tax, making no allowance for out-of-state sales taxes, is in fact an effective trade barrier. It should be noted, however, that the courts occasionally attempt to evade a direct answer to this question by shuffling the various taxes by name—as the New York court did in the *O'Kane* case.

Passing from such verbal metaphysics to actualities, it must still be conceded that under some circumstances, a use tax which fails to allow for a sales tax imposed by another jurisdiction is unobjectionable. For example, if no sales tax can be imposed except by the state of the purchaser, there is no possibility of this problem even arising; but as already shown, it is by no means certain that the state of the seller is precluded from imposing the tax. Furthermore, such a use tax imposed by a jurisdiction like New York, which imposes no personal property taxes, may be all right, since the use tax may well be regarded as in lieu of a property tax. And on somewhat similar reasoning, a tax on the use of gasoline or similar commodities as a fuel for transportation need not make any allowances for out-of-state sales taxes, since the use tax is itself proportioned to the actual consumption in the state and is in no way supplementary to a sales tax; indeed in such cases the same state will often impose both a sales and a use tax without either tax making any allowance for the other.[23]

But where, as is usual except in the situation just mentioned, the use tax is supplementary to the sales tax and makes allowance for the sales tax paid by the purchaser to the same state, the imposition of a use tax without allowing for a sales tax actually collected by

[23] See Brown, "The Legal Aspects of Trade Barriers," (1940) 25 *Bulletin of the National Tax Association*, 98.

the state or the seller is a definite trade barrier, at least to the extent that the burden of the sales tax is passed on to the purchaser. This is because a purchase from a seller outside the state necessarily involves a sales tax in that state plus a use tax in the state of the purchaser's residence or place of business; whereas a purchase from a seller within a state involves only one such tax, or, if both taxes are exacted, the total amount will be only that of the larger of the two taxes. Whether or not there is a difference in form, there is certainly the difference in substance that in an interstate sale the amount of the sales tax will be added to the use tax. This would seem to be at least potentially a substantial trade barrier. If the imposition on the same transaction of a sales tax by two states is objectionable—and even the most vigorous advocates of liberalism in construing state taxing power seem to admit that it is [24]—a use tax which allows for a sales tax paid to the same state but not for a sales tax paid to another state seems likewise improper.[25]

But assuming that all of this is true, the question still remains whether the courts will interfere. The courts certainly do not invalidate all trade barriers, and perhaps they are right in this, though no substantial barriers should be permitted.[26]

The first decision of the federal Supreme Court sustaining a general state use tax, *Henneford* v. *Silas Mason Co.*,[27] involved a Washington tax, which expressly gave a credit for all sales taxes imposed upon the acquisition of the article by the taxpayer, whether such tax was imposed by the state of his own domicile or some other. The court seized upon this provision as demonstrating that there was no improper burden upon interstate commerce since the total tax burden was the same whether the transaction was interstate or intrastate. This seems quite convincing, but by itself would indicate that the court would insist upon such a provision in all state use tax laws. However, the writer of the opinion (Mr. Justice Cardozo) added a distinctly disturbing *caveat* to the effect that such a provision is unnecessary. In the course of this he said, "A state, for many purposes, is to be reckoned as a self-contained unit," an idea which seems not only inconsistent with the whole principle of our economic national solidarity, but also with the statement of the same jurist in an earlier case [28] that a state cannot be permitted to put itself in a

[24] See McNamara, *op. cit.*, note 19, *supra*.

[25] This matter is more fully devoloped in Brown, "Judicial Trends with respect to Trade Barriers," Chap. XXV of the Symposium on *Tax Barriers to Trade*, published by the Tax Institute, Philadelphia, 1941. See also the note in (1941) 6 *Mo. L. Rev.* 57.

[26] See Waters, "Interstate Trade Barriers" (1941) 19 *Taxes* 472.

[27] *Supra*, note 11.

[28] *Baldwin* v. *Seelig*, 294 U. S. 511 (1935).

position of "economic isolation." It is submitted that this earlier idea of Mr. Justice Cardozo was much sounder than the theory which he propounded in the *Silas Mason* case.

Unfortunately, however, Mr. Justice Cardozo's successors have seemed more favorable to his "self-contained unit" idea of a state than to his disapproval of economic isolation. To be sure, the court has from time to time, but with no great consistency, condemned state taxes which were deemed to lead to the possibility of "multiple burdens." [29] But when this very problem of a non-compensatory use tax came before the court, it declined to apply its supposed prohibition of multiple burdens. The case referred to is *Southern Pacific Co.* v. *Gallagher*,[30] where a California use tax was sustained, notwithstanding the fact that that law explicitly refused any credit for out-of-state sales taxes.[31] The opinion in this case was written by Mr. Justice Reed. He cited the *Silas Mason* case as conclusive, as indeed it is if we accept the dictum in it, just referred to. Mr. Justice Reed tries to persuade himself that there is no discrimination, on the ground that use within a state is not interstate commerce. This is another example of trying to ignore actualities by clever use of names. However, he finally frankly concedes the possibility of discrimination, but holds that it should not be interfered with until actual discrimination is shown, and perhaps not even then.

The answer to the question whether the court will compel an allowance for an out-of-state sales tax has therefore not been definitely made; but the prognosis does not seem very hopeful. Even if the court does refuse to abdicate its power and responsibility to prevent serious trade barriers between the states, it is not very likely to interfere in this situation. The court is likely to feel that this barrier is not a serious one, especially in view of the uncertainty as to how far sales taxes are actually passed on to the buyer, that any such prohibition could probably be evaded by the use of excise taxes on production, and that in any event the state is a self-contained unit and its taxing power should not be restricted by that of other states. It must be granted that we should not expect the courts to solve all our difficulties for us, though it would seem that this is serious enough to justify their interference. But it seems rather improbable that they will help in this situation, unless indeed they do prohibit any sales tax except by the state of the buyer. This would automatically solve the difficulty, but here too one cannot be very optimistic as to the probability of the Supreme Court's prohibiting more than one tax.

[29] See Brown, *op. cit.*, note 25, *supra.*

[30] 306 U. S. 167 (1939).

[31] Since the *Silas Mason* decision, the Washington use tax law has also been amended so as to deny any credit for sales taxes imposed by other states.

SHOULD EITHER THE SALES TAX OR THE USE TAX BE GIVEN UP?

Since the original basis for the use tax—that is, to fill in the gap in sales taxes on interstate transactions, a gap which no longer exists—is not now available, the suggestion has been made that the use tax should be given up by the states, and the sales tax alone employed. Conversely, the suggestion has been made that the sales tax be given up, and the use tax take its place.

Theoretically, either tax will function satisfactorily alone, and to adopt either of these suggestions would at least partially solve the problem of trade barriers with respect to them, which has just been discussed. But the practical desirability of either suggestion depends upon the collectibility as well as the legality of the imposition of the two taxes. Accordingly, this problem of collectibility must be given brief consideration.

It is obvious that a state can effectively collect a tax on all sales within the state and perhaps on all sales, no matter where the title passes, where shipments are made to destinations within the state.[32] Here the seller can be compelled to collect the tax. But it is completely impossible to collect a tax on sales made to residents of the state where the sale is outside the state and delivery is made there. Obviously the seller cannot in any way be compelled to collect this tax, whether or not he does business in the taxing state, since he has no way of knowing the residence of his customers. This difficulty can be largely avoided by the use tax, but this very thing seems a decisive objection to the proposal to abolish the use tax.

Now as to the use tax. Here the federal Supreme Court has recently extended the power of the states to collect, and has thus increased the desirability of employing the tax.

In *Felt and Tarrant Mfg. Co.* v. *Gallagher*,[33] the court held that a seller may be compelled to collect a use tax on goods sold to purchasers within the state even though the seller was a foreign corporation and did no business within the state except in respect to interstate sales. This doctrine was extended this year to permit a state to compel mail-order houses doing business in the state by conducting retail stores to collect a use tax on mail orders by residents of the taxing state.[34] The court brushed aside the contention of the mail-order houses that their retail store business in the state was completely separate from their mail-order business and there-

[32] This latter proposition is not entirely clear. Almost certainly such collection cannot be by ports-of-entry. See Brown, *op. cit.*, note 23, *supra.* But probably collection can be by methods analogous to those sustained with respect to use taxes, as set forth, *infra.* Cf. Graubard, "Special Problems in the Levy of Municipal Excise Taxes," (1941) 8 *Law & Contemporary Problems*, 613.

[33] 306 U. S. 62 (1939).

[34] *Nelson v. Sears, Roebuck & Co.*, 312 U. S. 359 (1941); *Nelson* v. *Montgomery Ward & Co.*, 312 U. S. 373 (1941).

fore subjected them to no liabilities in connection with the latter, saying that doing any busines in the state subjected them to the liability to collect the use tax with respect to all sales to known residents of the state.

All this is quite satisfactory from the standpoint of the states; but, as the court admits, this will not enable a state to compel the seller to collect a use tax upon shipments in the state if the seller does no business there.[35] Still less can an out-of-state seller be compelled to collect a use tax if the sale is consummated and the goods delivered in the outside state. This is true even though the seller does business in the taxing state, for he has no way of knowing the residence of purchasers who go outside the state to make their purchases and take delivery there. In that situation neither sales nor use taxes can be effectively collected, except by taking the arduous course of going directly against the purchasers—a scheme which will work very well in large transactions, but is obviously impractical with respect to ordinary household purchases.

On the whole, then, the use tax seems more desirable, and if either is to be given up it should be the sales tax. The sales tax is desirable in that the state can go directly against the few sellers rather than the numerous purchasers; but the same is true of the use tax in many cases, and in those where it is not, the sales tax is likewise largely ineffective.

But why give up either tax? While a sales tax has perhaps no theoretical advantage over a use tax, yet experience shows that it is sometimes actually more desirable, especially from the standpoint of collection procedure. And the use tax has in many circumstances important advantages over the sales tax. Why not choose between these advantages by taking both?

As already indicated, the writer's opinion is that the use tax should, in the usual case, be credited with all sales taxes actually paid by the taxpayer to the state imposing the use tax or to any other state. This last limitation is unnecessary if it is finally decided that only the state of the purchaser can impose a sales tax; but pending authoritative settlement of this question, it seems desirable. But at least with this limitation, there seems no objection to the imposition of both sales and use taxes by each state, and no reason for any state to give up either of them.

Chairman Nims: I now present Mr. John W. Slocum of the Kansas Tax Commission who will discuss Use Taxes.

[35] Some attempts have been made to compel the seller to collect the tax in this situation by such extra-legal methods as suing certain of his customers within the state for the tax, with the purpose of destroying the seller's good-will. See Brown, "The Future of Use Taxes," (1941) 8 *Law & Contemporary Problems*, 495. But such expedients are obviously of rather limited scope.

USE TAXES

JOHN W. SLOCUM
Kansas Tax Commission

To this Conference we bring greetings from the State Commission of Revenue and Taxation, Chairman, Mr. John McCuish, Mr. Wm. Ljungdahl and Mr. Fred Horn, Commissioners, and Mr. Bert E. Mitchner, Director of Revenue.

During the time when we had only the sales tax law, it was believed that if a sales transaction involved actual and physical movement of property across state lines, and if this movement was an essential part of the sale of the seller, being required by the expressed terms of the contract of sale to make a physical delivery of the property sold across a state boundary line, the transaction was within the rules and regulations under the interstate commerce clause of the federal constitution. The mere fact of making an interstate delivery was held to be sufficient if the seller was free to perform his contract by shipping from stock in the taxing state.

In seeing this complication, California and Washington were the first two states to pass laws covering such sales in 1935. These use and compensating tax laws were to complement their existing sales tax laws. Such a tax was given court approval even though the property was brought in from other states. Further progress was made in 1937, when the court decision, involving the Silas Mason Company, was given, upholding the validity of such tax and deciding that the tax was not levied upon operations in interstate commerce but upon the privilege of use, after commerce was at an end.

Most of the laws passed contained provisions requiring the out-of-state seller to collect the tax as agent for the taxing state, even though the use tax laws imposed primary liability for payment of the tax on the consumer or buyer. These provisions were inserted in the laws to aid the states in enforcing payment of the tax due to the difficulty of enforcement against the individual consumer or buyer.

Again in 1939 the United States Supreme Court decided that the enforcement of the collection through the medium of the seller corporations, was valid because it was not such a substantial burden on interstate commerce as constituted a violation of the interstate commerce clause of the constitution. You will recognize this ruling as being given in the *Felt and Tarrant* case. This decision firmly establishes that in determining the extent to which a state may enforce collections of the use tax through the medium of the seller, the question of whether or not the seller is *doing business* in the state, in the sense of intrastate or local business, is an immaterial consideration.

Further decisions in 1940 continued to make collections of use or compensating tax easier. The *Berwind-White* case decision let down the bars still farther as to the powers of the states to tax interstate sales. The court said: "The tax is conditioned upon a local activity, delivery of goods within the state upon their purchases for consumption. It is an activity which apart from its effect on the commerce, is subject to the taxing power."

Evidently the United States Supreme Court adopted the precedent principle that state tax which does not unduly burden interstate commerce is valid. The court recognizes that states require tax revenue to carry out their governmental functions. It does not interpret the federal constitution as preventing the states from laying any tax upon persons engaged in interstate commerce or upon interstate transactions. It tries the power of Çongress to regulate such business and becomes invalid if the state has the effect of singling out interstate business for especially heavy burdens. It appears the court concedes that a tax which might be imposed by the interstate business in all states invalid. Prentice Hall states that: "The character of the tax must be ascertained by its incidence and effect"; the designation given it by the legislature is entitled to considerable weight, but not conclusive. Taxes designated as "use" or "compensating" taxes are regarded as excise taxes and not as property taxes, and, therefore, are not subject to state constitutional provisions requiring uniformity of taxation or imposing rate limitations. They involve the exercise of rights incidental to ownership, as distinguished from sales taxes which involve the transfer of ownership or possession. But one finely-drawn decision requiring use and consumption to be reported as a sale was held to be a sales tax, and outside purchases were therefore exempt.

We can say there are two types of interstate sales:

1. A sale wherein goods from within a taxing state is sent to a buyer in another state;
2. A sale where goods are sent from a place outside a taxing state to a purchaser in the taxing state.

Use taxes or compensating taxes, we can say, are good revenue producing taxes. But we can also find that this form of taxes avoids payment of sales tax through outside purchases, and that it also places local business on even terms with interstate commerce, which is exempt from sales taxes under certain circumstances.

The use tax question, we continually realize, is a taxation field in a chaotic condition. The laws are forever changing and administrative rulings and regulations of the various state taxing officials add to the complexity of the situation. Each specific problem must be studied from its own factual situation and from the laws and regulations of the particular taxing jurisdiction involved.

As for a general definition of use or compensating taxes, we might state, that it is a tax on the use, storage or other consumption in a given state of tangible personal property purchased outside of the state. The use tax is often regarded as one of the reprehensible barriers to the interstate movement of goods. It is a levy designed to supplement a state sales tax in order to cover goods of out-of-state purchases. These are exempt in most states to the extent of a sales tax paid elsewhere.

There is much to be said in favor of use taxes. Local merchants near state borders are at a disadvantage with a state sales levy unattended by the compensating tax. Their customers go over the state line to avoid the sales tax by buying in tax-exempt interstate commerce. Thus intrastate commerce is discriminated against in favor of interstate. If an amount equivalent to the sales tax has to be paid by such buyers, the incentive for deserting the home merchant because of the tax differential disappears. The effect of enactment of a use tax is to restore trade to the channels taken before the sales tax was adopted. Of course, the two combine to curtail the volume of all trade.

Kansas was in the unfortunate position of being written up in newspapers and magazines as having erected trade barriers, by placing ports of entry on its borders. We Kansans do not think of our ports of entry as trade barriers. We think of them as checking points. I believe Frank Bane explained our situation very well when he stated at a recent conference held in Topeka, "I think it is generally so discussed and generally agreed upon, that a port of entry is a trade barrier only if it is designed and operated in such a fashion as to be wholly to the advantage of that state's products; but that a port of entry is not a trade barrier when operated as a quarantine measure; or when it guards the safety of the highways. When it is a revenue proposition and when it does not militate against the products of other states to their disadvantage, and the advantage of the state having ports of entry."

There are many and many border-line cases as to whether or not such and such a regulation constitutes a trade barrier. We have to remember that it depends on the method of operation and what the state does with the tax collected, and to keep in mind that if such a law as a port of entry or other ways of taxing is administered for the purpose of raising revenue, it is not a true barrier, but if such a law keeps products of a particular state out of another state, then it is a trade barrier. Trucks entering our state must stop at stations on the borders; here the truck and its cargo are inspected and clearance papers are made out. Although ports of entry sometimes are considered a source of inconvenience and delay, it must be admitted that they constitute a fairly efficient means of administering existing state laws.

Upon arriving in St. Paul, and after talking with the delegates and fellow conventionites, we found a great interest in our "Port of Entry" system in Kansas.

The port of entry system or plan was instituted by Kansas in 1931, or less than ten years ago. We feel that the system has accomplished for our state an efficient means of exercising a reasonable control over motor carriers, with an absolute minimum of difficulty and without hampering freedom of commerce as is carried on by motor vehicles. The Federal Motor Carrier Act of 1935, passed by Congress, limits the several states having such ports in control of interstate traffic. However, there remain to the states the exercising of two very important functions:

1. To regulate and control such operations insofar as may be necessary to protect their citizens.
2. The right to collect from the carrier a reasonable tax to compensate, in part at least, for the use of the highways of Kansas.

We find that our port inspections eliminate many unfair and fraudulent trade practices. The out-of-state operator, in going through our ports of entry, is subject to no discriminatory treatment. The requirements are no different for him than they are for the Kansas resident, except that he is required to appoint a resident agent to receive service of legal process. The procedure for the tax payments are identical with that of the Kansas resident. The ports of entry of the State of Kansas never have been and are not now in any way instrumentalities of discrimination against carriers from other states. It must be stated that under the Kansas act, the owner of livestock or producer of farm products is exempt from payment of a mileage tax, and this is true of Kansas residents as well as residents of other states. It follows, then, that persons transporting their own property, where this property is not for sale, lease or bailment, are totally exempt.

It is interesting to note that the "Western Trade Barrier Conference" held in Denver, Colorado, in 1939, under the auspices of the Colorado State Chamber of Commerce, at which ten midwestern states, including Kansas, were represented, adopted the following resolutions:

> "Be it resolved that this conference go on record as declaring that *ports of entry* in the states represented here, do not constitute trade barriers within the meaning as defined by the Council of State Governments, and be it further resolved that this conference go on record endorsing the operation of Ports of Entry in the several western states represented, until such time as better or more economical systems can be devised for collecting taxes justly levied against interstate and intrastate operators alike . . ."

The ports of entry assist in the collection of use taxes. In the inspection of cargoes at each port notations are made regarding contents of shipments. These notations are checked in due time to see if proper taxes have been paid thereon.

In Kansas we are particularly happy with the increase collections as shown by our Compensating Tax Division. In the 1939 fiscal year, the department collected $253,799; in 1940, it was $444,466; then in 1941, a total amount just double to that of 1939, or $526,297. This increase shows that this division is working toward a more efficient way of collecting compensating taxes.

Collections made under this category are placed in the retail sales tax fund, and used by the social welfare agency to help the needy aged, the blind, and the dependent children and schools in Kansas. Gentlemen, I have in my brief case, forms used by the Kansas Department of Compensating Tax. If any one would like to see them I shall be very happy to show them to you. Just one more thing. We have with us here at the convention, and he is present in this meeting today, a gentleman by the name of Mason Mahin, an attorney in the Legal Division of the Kansas State Commission of Revenue and Taxation. Mr. Mahin devotes a great deal of time to the problems of which we have been speaking. We, in Kansas, give him credit for the substantial increases in compensating tax collections in our state. Mr. Chairman, with your permission, I should like to have Mr. Mahin stand for recognition. Perhaps we shall hear from him in our discussion period.

CHAIRMAN NIMS: I now present Mr. C. B. Allyn of the Jewel Tea Co., who will discuss the problems of retailers in sales and use taxes.

PROBLEMS OF RETAILERS IN SALES AND USE TAXES

C. B. ALLYN

Assistant Comptroller, Jewel Tea Co.

In the 1940 conference, the legal aspects of state sales taxes and use taxes were very fully discussed. After the learned papers by Dr. Powell and Professor Rodell in that conference, and the further fine papers this year by Prof. Brown, Prof. Rottschaeffer and Mr. Dodd, we must surely be fully informed regarding the law. I would be bold indeed to attempt to add to their interpretations. We cannot say, however, that the legal limitations, if any, upon state sales and use taxes are perfectly clear in our minds because these interpretations seem to lead us into a legal labyrinth of conflicting principles—a fog of terminology in which things are not called by their right names but are designated something entirely strange to common laymen's terms in order to support the fiscal policy of the state or city. In fact this confusion and doubt as to what the law of the land really is, is freely admitted and stressed by our legal analysts.

Probably this vice of calling things by another name in order to justify some action is a devolution from recent international practice, particularly by Mr. Hitler. Take for example the word *defense*. You will remember that Germany sent three army corps into Poland in *self-defense*. And the word *protection*. When one nation extends its protection to another, one might think it was guaranteeing the safety of that country. Of course, in fact it has turned out to be the same kind of protection which the rabbit hunter extends to the rabbit.

At least we may say that the U. S. Supreme Court is more frank in its later decisions when it tells us, in effect, that it will use rubber bands to measure the rights of states to tax commerce between states. The court also seems to jump all boundary lines to reach extraterritorial transactions. The language in the *Wisconsin Privilege Dividend* case, State of *Wisconsin* v. *J. C. Penney Company*, is illuminating—" A state is free to pursue its own fiscal policies, *unembarrassed by the Constitution*, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." One might suppose that it was an inherent obligation of any community to maintain an orderly civilized society. If maintaining an orderly society permits a community to tax interstate commerce there is no restriction left except the conscience of the community.

And again in the same opinion—" The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction." Under this language is there any legal barrier to prevent a state from levying a tax on a transaction occurring entirely outside its borders as long as there is a nexus, however faint, connecting the transaction to the state. Maybe Texas can tax the retail sale of natural gas in Illinois or possibly Washington can tax the retail sale of Walla Walla apples in New York.

So possibly we must turn away from our courts and our legal approach and rest the case for equitable and wise taxation upon the shoulders of state administrators and state legislatures. *Whether or not* a state can legally discriminate against interstate transactions; *whether or not* a state can levy taxes on transactions or property beyond its borders, good common sense advises against killing the goose that lays the golden eggs. Eight states with sales and use taxes, (Alabama, California, Colorado, Iowa, Ohio, South Dakota, Washington, Wyoming), do not permit reciprocal exemption from use taxes, for sales taxes paid to other states. In other words, property purchased in one state and brought in to any other of these states for use, is taxed again. This does not sound fair to the taxpayer and actually puts interstate commerce at a disadvantage.

One instance comes to mind where an auto was purchased in Denver, Colorado, and delivered to taxpayer's agent for use in Wyoming. Colorado insisted on a sales tax and Wyoming insisted on a use tax. We presume that this car would be subject to use tax in the other six states which do not exempt property upon which sales or use taxes have been paid to another state, if it was used in those six states.

Of course, the temptation exists to favor local commerce by discriminatory legislation against the interstate merchant but the wisdom of this course is doubtful. The people of this country have enjoyed freedom of commerce and movement over state lines for too many decades to now willingly accept the handicap of state tariffs. It is begging the question to say that the taxpayer is foolish to buy or sell across state lines. Business cannot shut its eyes to other major considerations such as transportation facilities, natural market area boundaries, service requirements of customers, labor supply, etc. In the above example of the car purchased in Denver, the state would probably have exempted the sale if the order came from a Wyoming branch office and delivery could have been made in Wyoming. But it is uneconomic for a dozen reasons to maintain a branch in Wyoming. Is that fact a justifiable reason for a discriminatory burden on the interstate transaction?

The consumer and merchant in interstate commerce ask no special favors over local commerce but they do ask for parity of taxation. Maybe both states should share the sales tax where a transaction originates in one state and is consummated in another state. Unless states can find a way to achieve practical parity, the certain eventual result will be further restriction on state powers and greater centralization of taxing powers in Washington.

One of the peculiarities of our state sales taxes is the provision in so many acts cautioning and threatening the retailer to pass on the tax. Not only is he ordered to pass the tax on by announcement, placard, advertising and separate billing, but he must pass it on in the exact amount down to the very fraction of a penny. Whole pennies are not accurate enough to measure this tax in many states so the deputy tax collector (the retailer) is supplied with a new and more accurate currency consisting of slugs or tokens or bottle caps and, in one state, pads of prepaid tax stamps. With the help of these novelties, the retailer is expected to extract from his customer the exact amount of tax and remit this amount to the state. Thus we have millions of yards of red tape added to the expense of doing business and this tape has, in most cases, been added at that very vulnerable point—the closing of the sale. I have no estimate of the number of retail transactions in the whole country every day. My employer is a small concern and we have approximately 140,000 sales to customers every day so the daily total of transactions must be in the billions. And in about half of these transactions (in sales

tax states) the retail clerk must write a separate line on the ticket or push the cash register an extra time—not to mention the computation of the tax. Of course, the simple multiplication of the sale—let us say \$1.17—by the rate of tax, 2% or 3%—does not require any great proficiency in mathematics — in fact a printed schedule showing the amount of tax is supplied in many states. But we do add to the time required to transact business this small additional time on each of the billion sales made every day. In Ohio the law requires tearing off one or more prepaid tax stamps and handing the torn half to the customer. This is a serious nuisance to both retailers and customers and is heartily cursed by everyone.

In many states the amount of tax must be meticulously collected from each customer. It is difficult to understand the value of these passages in the law unless the state takes over the responsibility for all pricing, costs, and margins. Here for instance one law says, "The vendor shall collect the tax from the vendee but in no case shall he collect as tax an amount in excess of the tax. . . ."

I presume this provision is to prevent the retailer from collecting more than the exact tax from the consumer. The regulation in this state says, ". . . the vendor is required to collect the tax from the vendee with respect to all transactions subject to tax. In all cases the full amount of the tax must be added to the sales price and collected as a separate item. It will be considered a violation of the Act for the vendor to absorb the tax or to consider that the tax is included and collected as a part of the sales price. The total purchase charge on sales must not be quoted in fractions of one cent for the purpose of eliminating the use of tokens."

As long as the merchant has the right to establish the price at which he will sell, it seems futile to complicate trade by attempting to maintain the identity of this tax. The levy is placed on the retailer just as the social security tax, property tax or income tax. His problem is to raise this amount of money from his customers. He must consider all his costs of doing business when determining price—the competitive situation in most businesses is paramount. If he can get the sales tax cost with less business loss by increasing the margin on fifty items and decreasing margin on other items in his line, that is what he will do without regard to whether or not the tax is figured by the clerk on each sale. If the increased cost of a sales tax in a certain state is offset by reductions in other costs such as freight rates, the merchant may be able to hold his price structure without change. It seems unwise to make provisions for passing on the tax too rigid. Some types of retailing lend themselves to separate collections and others do not. If authority for this can be permissive rather than mandatory, we will accomplish the objectives with the least possible disturbance of trade and wasteful red tape.

Many retailers do not use the fractional tokens because they find the customers look upon them as a nuisance and they waste the retailer's time and slow down his service. In some states fractional cent tokens were issued by the department at the request of a few merchants. The idea was not accepted generally by either retailers or the public, so they were subsequently discontinued. In other states they have continued to use tokens with satisfaction. When the amount of sale runs from half a dollar upward, there seems no need for them. However, I cannot speak for the purveyor of Coca Cola or Saturday Evening Posts. The customer will not willingly pay 21c. for four cokes if one sells for a nickel without a tax charge. Several solutions offer themselves — use smaller glasses or reduce the cost of the item in some manner, or—raise the price of cokes to 6c. or—(and this is the solution we prefer) *sell more cokes* so that the additional gross margin will make up the increased tax cost.

There is one other phase of the separate collection of the sales tax which warrants comment — it does make the public tax conscious. Most of us believe generally in promoting tax consciousness — we fear hidden levies which are forgotten by the public and we long to see every citizen throw off his apathy and take a deep and abiding interest in taxation. We have here, gentlemen, a tax with the maximum capacity for instilling tax consciousness in all the people even down to the lowliest. It reaches the pocket of all classes from the schoolboy to the builder of a skyscraper. Not once a year or even every payday like the Social Security taxes—but many times every day as we buy our daily needs of food, clothing or other necessities—we hear constantly the refrain of the retail clerk—that will be $1.03 with the tax. We see an item advertised at 89c. and rush happily up to buy it. We happen to have the correct change which we carefully count out. The clerk counts the change and sheepishly says, "That will be 91c. with the tax."

It is a little unfortunate that the business of retail distribution is deputized to instill this tax consciousness in the public. You can well understand that the delicate relation between the salesman and prospective customer cannot stand a great amount of argument about the fiscal needs of the state. By and large it has been our experience that the customer prefers that the price quoted to her to be the final price. The request for an additional amount reminds the customer not only of the sales tax but also of all the things she does not like about the government, taxes in general, and even the merchant himself.

Of course we do not have knock-down-and-drag-out battles with our customers except in a few states where consumer tax strikes have been successful (like New Jersey). If you will stand in the shoes of a retail salesman who has to meet the customers face to face all day and tell them how much additional for tax, you will hear a few arguments and a few nasty comments about our govern-

ment expenses. The additional request for tax is an excellent irritant if that is what we seek. However, as time goes on, the irritation lessens and consequently there is less trouble for the deputy tax collector (the retailer).

The one thing that seems silly to taxpayers is the multitudinous differences in the 23 state sales tax statutes. Is there any good reason why an exchange of property such as the trade-in of an old car should be taxed in some states and not in others? Can the merchant pay taxes out of his second-hand car lot? Is there any good reason for handling transportation charges in four different ways? Why should credit sales be taxed in four different ways—the full tax at the time property passes in seven states—payment as installments are paid in seven states — optional handling in eight states—and optionable except where credits are covered by negotiable note or sales contract in one state. Why the many variations in the collection of tax by the retailer and in the exemptions provided? Why should we have 58 different exemptions appearing in one or more of our 23 statutes? Why should school books be exempt in five states; why should ice be exempt in North Carolina, and gas-filled dirigibles be exempt in Ohio?

And what of the variety of regulations governing the situs of the sale? The rules are customarily set up to claim the tax on all sales even remotely related to the taxing state. If the proper basis is the place where legal title passes, then can't we have an agreement of minds to all abide by that location without having two or three sets of different regulations working on the same sale. Or if that rule is too weak, possibly the taxable situs should be the state where the property sold is finally delivered and put into use. This seems to be the present trend, and if the state in which manufacture, purchase, shipment or storage takes place will forego the tax, an agreement might be reached to tax at the point of final delivery.

Chairman Nims: Mr. Robert Granville Burke will now discuss the place of compensatory or use taxes in the American economy.

PLACE OF COMPENSATORY OR USE TAXES IN THE AMERICAN ECONOMY

ROBERT GRANVILLE BURKE

Director, Emergency Revenue Division, City of New York

Social and economic depressions have a peculiar way of leaving in their wake widespread ruin to the fiscal policies of governmental units. Both during and after the unprecedented depression of the early nineteen hundred thirties, federal, state and local bodies found their revenues sadly depleted. Unemployment reached a new high and business a new low during this period.

Governmental units found themselves face to face with the very serious problem, among other things, of providing care for those who were suffering by reason of the hardships caused through general unemployment. The federal government, to a large measure, placed the burden of handling the relief situation directly upon the states, which, in turn, because of their already heavily-laden budgets, passed the burden on to their local municipalities and counties. No governmental unit was spared.

The great metropolis of New York City found itself in a comparable position with the smallest hamlet of any state. In fact, it might be more accurately said that large cities such as New York which were urban centers of population found themselves in a much worse-off position, for theirs was the job of providing for the large unemployed among their own and for the migrants whose footsteps in the time of stress turned toward the cities.

The City of New York, particularly in 1933, was faced with the problem of providing ways and means of taking care of some 830,000 persons who were then on relief rolls. This number reached 1,267,000 in 1936. With 11.6 per cent of the population in the City of New York receiving relief in 1933 and with the sum of 44,000,000 needed to finance the city's share of the relief burden in addition to its ordinary budgetary expenses, the question with which the administrators in New York City were faced was, namely, where was the additional revenue to come from? Ordinarily, bonds would be floated to provide the monies sufficient to take care of this expense. However, in 1933 the credit of the City of New York, like the credit of the great majority of other cities and towns throughout the United States, was very close to the breaking point. Real estate was being taxed to the limit. New sources of revenue were imperative.

Many suggested proposals were made. The majority of the same had to be disregarded for the reason that the revenue resulting would not be sufficient in amount to take care of the financial crisis that had presented itself. For example, toll taxes on bridges, or taxes on savings banks and insurance investments, taxes on the ownership of automobiles, taxes on the income of stock brokers, and taxes on transfers of shares of stock were all proposed and discarded. It seemed that the only worthwhile solution to the financial problem would be the imposition of a local sales tax. Of course, the city had no authority in and of itself to impose such a tax, and it was necessary that enabling legislation be granted the municipality by the State of New York.

In 1933 the first enabling act was passed.[1] Only one local tax was imposed pursuant thereto, and that, a tax of one and one-half

[1] Chapter 815, Laws 1933.

percent on the gross income of public utilities.[2] Permission was given to use the money realized from this tax for budgetary purposes. However, the revenues were far short of the requirements, and it was not until 1934 that a third enabling act[3] was enacted at the behest of Mayor LaGuardia in order to place the city's relief program upon a pay-as-you-go basis.

A tax program calculated to produce about $65,000,000 annually was projected,[4] and for the first time was presented a complete local taxing program under the powers delegated by a state to a municipality thereof.

New York City was the pioneer in this field of local taxation, and while its example and its experiences were followed by other localities, it may, I think, be safely said that no state or local tax program so comprehensive in its scope and with such revenue producing possibilities was ever enacted.

I do not propose to go into detail concerning the administration of the New York City taxes, for I realize that I am addressing, primarily, a group of tax administrators and tax counsel from various states and municipalities whose problems undoubtedly differ in a greater or lesser degree from those with which we have been confronted in New York City. At the conclusion of this paper I shall address myself to any questions any of you may have with particular reference to the administration of the local taxing program in the City of New York. However, I have felt this introduction was somewhat of a necessity in the light of the topic which has been assigned to me for this meeting today.

As I have indicated, a sales tax law was offered as a panacea for our local ills.[5] Innumerable transactions would fall within its pur-

[2] Local Law 19 of 1933.

[3] Chapter 873, Laws 1934.

[4] Under the powers given the city through enabling legislation, the following tax program was actually put into effect:

(a) Two percent consumers retail sales tax. (Local Law 20 of 1934.)
(b) Personal property tax which was used as a compensating measure for the sales tax and was imposed upon property owned or situated within the City of New York upon which no sales tax had been paid. (Local Law 25 of 1934.)
(c) Three percent tax on the gross income of all public utilities. (Local Law 21 of 1934.)
(d) One-tenth of one percent tax upon the gross receipts of persons engaged in business for gain or profit in the City of New York. (Local Law 17 of 1934.)

There were also imposed local income and inheritance taxes (Local Laws 18 and 22 of 1934 respectively), but both these laws were repealed shortly after their enactment.

[5] The term "sales tax" as used herein refers to an excise tax as distinguished from a property tax. It applies to retail sales of tangible personal property and is usually measured by the selling price of the property or the gross receipts from such sales.

view. The tax to be imposed under it would be payable by the general public in direct relation to its ability to purchase. From an administrative point of view, the collection of a sales tax would be comparatively simple through deputizing the various vendors of tangible personal property or utility services as agents to collect the tax from their respective vendees. The actual taxpayer or consumer would have little or no contact with the body administering the tax law.

To some economic theorists this type of levy was repulsive because of its regressive nature. But legislatures generally, I think, have, in passing sales tax laws, ignored this argument as a minor short-coming.

Sales tax legislation once begun was found to gather momentum rapidly. Experiences in one jurisdiction would indicate the way to still other jurisdictions and the path towards this new field of taxation was gradually broadened and lengthened until today we find sales tax laws in force in 23 states [6] and half a dozen or more municipalities.[7]

The importance of the sales tax in the over-all taxing structure of the nation is eloquently attested to by the fact that in 1940, 39½ percent of the state tax yield throughout the country was derived from the imposition of sales taxes.[8]

I do not propose to cover in this paper the myriad of problems that arose in connection with the administration of state and local sales taxes; but it would not be amiss, I think, to point out that the foremost problem arose from the application of the interstate commerce clause of the federal Constitution. Certainly, no other feature of sales tax laws has given rise to so much litigation as has the question of the right of taxing jurisdictions to impose sales taxes upon purchases of tangible personal property which, either of necessity or design, are transported in interstate commerce.

The courts, in interpreting the sales tax levies of recent vintage had as precedents cases involving sales taxes on a particular commodity such as, for example, gasoline.[9] The United States Supreme

[6] Alabama, Arizona, Arkansas, California, Colorado, Florida, Illinois, Indiana, Iowa, Kansas, Michigan, Mississippi, Missouri, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, South Dakota, Utah, Washington, West Virginia and Wyoming.

[7] City of New York, Tampa, New Orleans, St. Louis, Kansas City, and several West Virginia municipalities.

[8] U. S. Bureau of Census report, 1941.

[9] *Helson* v. *Kentucky*, 279 U. S. 245 (1929). The plaintiffs in error were engaged in operating a ferry between Illinois and Kentucky, a purely interstate business. Their office and place of business and the situs of all their personal property was in Illinois. 75% of the gasoline used to create the motive power in the boat was consumed within the limits of Kentucky but all of it in interstate journeys. The tax was computed and imposed upon the use of gasoline thus consumed. The court held such a tax a direct and undue burden on interstate commerce.

Court found that such taxes were a direct burden upon interstate commerce and were therefore unconstitutional.

Still earlier precedents were set up in some of the "ancient" decisions pertaining to taxes imposed by states and localities where the primary intent of the taxing jurisdiction was to discourage competition from other jurisdictions,[10] and which intent was so patent that the imposition of the tax imposed resulted in not only discrimination against interstate commerce, but in a direct burden thereon.

And so it was with such precedents before it that the Supreme Court felt itself obligated to hold many of the sales tax levies invalid as being unduly burdensome upon interstate commerce.

Certiorari was denied by the Supreme Court in two cases coming from my own jurisdiction after the New York Court of Appeals had held that the imposition of a sales tax upon merchandise ordered in the City of New York for delivery therein which necessitated a shipment from out-of-town sources was an undue burden upon interstate commerce.[11]

It must be admitted, however, in all justice to the Supreme Court that it had previously thereto taken a position that all interstate commerce sales were not free from state taxation, and that it had made an effort to uphold the constitutionality of some of the state sales tax laws by attempting to define a transaction in interstate commerce. It is well accepted that a transaction in interstate commerce must, of necessity, involve a shipment of property across state lines.[12] The Supreme Court, however, was able to sustain a state sales tax imposed upon the sale of merchandise which, of necessity, had to cross state lines, on the theory that the contract calling for the delivery of the merchandise purchased *did not necessarily require shipment from a point outside the state.*

In the *Wiloil Corporation* v. *Pennsylvania* case,[13] a sale was made by a vendor through agents in Pennsylvania for delivery in Pennsylvania of gasoline sold at a specified price per gallon "f.o.b. Wilmington, Delaware plus three cents tax." The bill of lading

[10] *Robbins* v. *Shelby County Taxing District*, 120 U. S. 489 (1887), held invalid a license tax of a fixed amount imposed upon the occupation of soliciting orders for subsequent delivery where such soliciting agent had no place of business in that state. See also *Alpha Portland Cement Co.* v. *Mass.*, 268 U. S. 203 (1925); *Cheney Bros.* v. *Mass.*, 246 U. S. 147 (1918).

[11] *National Cash Register Co.* v. *Taylor*, 276 N. Y. 208 (1937), certiorari denied *McGoldrick* v. *National Cash Register Co.*, 303 U. S. 656 (1937); *West Publishing Co. v. Taylor*, 276 N. Y. 535, Mem. (1937), certiorari denied *McGoldrick* v. *West Publishing Co.*, 303 U. S. 656 (1937).

[12] Warren and Schlesinger, "Sales and Use Taxes: Interstate Commerce Pays Its Way" (1938), 38 *Col. Law Rev.* 49, 59.

[13] 294 U. S. 169 (1935).

called for delivery within Pennsylvania. The Supreme Court in upholding the Pennsylvania tax on that sale said in part that:

> "As interstate transportation was not required or contemplated, it may be deemed as merely incidental. (citing cases) The act lays no burden on interstate commerce as such, and if any can be said to result from the imposition, it is indirect and precisely as that which would have resulted if deliveries had been made exclusively by intrastate transportation from Pennsylvania sources." [14]

From this opinion of the Supreme Court, it would appear that the real criterion for determining whether the sale in question was an interstate sale was whether the contract actually required the shipment across state lines.

In the *National Cash Register Company* v. *Taylor*,[15] the New York Court of Appeals held that a tax on sales of machines by a company with no factory within the City of New York, which machines were manufactured pursuant to so-called "special orders" to fit specifications and requirements of the vendors, were exempt from the tax because the contract for sale necessarily required interstate commerce. It is plain to see that such a holding which was affirmed by the United States Supreme Court in its denial of certiorari [16] very directly and adversely affected local businesses within the taxing jurisdiction of New York City. It enabled vendees in that jurisdiction to make purchases tax free from out-of-state points. To aggravate the matter, it was found that this situation was especially beneficial to the large-scale purchaser who was the potentially large taxpayer. At the time of this decision, the City of New York had a personal property tax [17] which was in a sense, and in fact was so held by the New York Court of Appeals, to be a use tax.[18] However, the personal property tax had its limitations in that it applied only to various enumerated types of tangible personal property which were owned or situated in the City of New York and upon which no sales tax had been paid.[19] It did not fulfill the requirements of a true complement to the sales tax for it permitted

[14] Ibid. at 175. See also *Ware and Leland* v. *Mobile County*, 209 U. S. 465 (1908); *Superior Oil Co.* v. *Mississippi*, 280 U. S. 390 (1930); *Bankers Bros. Co.* v. *Commonwealth*, 222 U. S. 210 (1911).

[15] See note 11, supra.

[16] See note 11, supra.

[17] Local Law 25 of 1934; Local Law 31 of 1935; Local Law 28 of 1936; Local Law 21 of 1937; Local Law 10 of 1938; Local Law 28 of 1938; Local Law 105 of 1939.

[18] *Williamsburg Power Plant Corp.* v. *City of New York*, 255 A. D. 214 (1938), aff'd. 280 N. Y. 551 (1939).

[19] Section 1 of Local Laws referred to in note 16 supra.

all but the enumerated items to be brought into and used in the city tax free.

Parenthetically, I should say here that states which had sales taxes experienced difficulties similar to New York City in the application of the sales tax to out-of-state purchasers, and those states likewise felt the immediate need of closing the door to tax avoidance.

The compensating use tax [20] appeared to solve the problem so far as interstate commerce difficulties were concerned because it was levied upon property sold or the use of such property *only after interstate commerce had ceased.* Invariably the use tax rate was the same as that for the sales tax levy. In many jurisdictions the use tax laws provided for an exemption in those cases where a sales tax had been paid to another taxing jurisdiction.

In its final analysis, the compensating use tax had for its primary purpose the protection of local business from out-of-state competitors. It is of interest to point out that the leading case upholding the constitutionality of the use tax answers the argument of discrimination against interstate commerce by stating that local commerce had an equivalent burden in that such commerce was subject to the imposition of a local sales tax. The Supreme Court in the *Silas Mason Company* case unequivocally placed its imprimatur upon the general theory of use taxes.[21]

From that point forward, it was but a short step to require a foreign vendor not authorized to do business within the taxing jurisdiction and doing purely an interstate business, to serve as an agent for the taxing jurisdiction in the collection of the use tax.[22]

[20] The "Compensating use" tax, interchangeably called a "use" tax, a "compensating" tax, a "personal property" tax and a "consumer's privilege" tax, is imposed for the privilege of using, storing or consuming within the taxing jurisdiction, articles of tangible personal property purchased by a user upon which no sales tax has been paid. It ostensibly differs from the "sales" tax in that the taxable event is the use of tangible personalty, whereas the taxable event under a "sales" tax levy is the sale of such property.

[21] *Henneford* v. *Silas Mason Co., Inc.*, 300 U. S. 577 (1937). At page 582: "The (use) tax is not upon the operations of interstate commerce, but upon the privilege of use after commerce is at an end." And further, "The privilege of use is only one attribute, among many, of the bundle of privileges that make up property or ownership (citing cases). . . . A state is at liberty, if it pleases to tax them all collectively, or to separate the faggots and lay the charge distributively. Ibid. Calling the (use) tax an excise when it is laid solely upon the use . . . does not make the power to impose it less, for anything the commerce clause has to say of its validity, than calling it a property tax and laying it on ownership." And further, at page 583: "A tax upon the privilege of use or storage when the chattel used or stored has ceased to be in transit is now an impost so common that its validity has been withdrawn from the arena of debate. (Citing cases.) . . ."

[22] *Felt & Tarrant Mfg. Co.* v. *Gallagher, et al.*, 306 U. S. 62 (1938).

In arriving at such conclusion, the Supreme Court relied upon the case of *Monomotor Oil Company* v. *Johnson*, which case had upheld the validity of a state tax requiring one engaged solely in interstate commerce to collect a tax from the local consumer.[23] In reaching its decision, the court found that the burden of collecting a use tax was not a burden upon interstate commerce. The actual burden was that of payment of the tax.

The compensating use tax, therefore, resolves itself to be nothing more than a legal fiction which permits that to be done indirectly which could not have been done directly by reason of the commerce clause prohibition.

In January of 1939 the cause for the legal sleight-of-hand of use taxation was virtually vitiated by the monumental decision of the Supreme Court of the United States in the case of *McGoldrick* v. *Berwind-White Coal Mining Company*.[24] In this legal landmark, on the subject of sales taxes, the court apparently came to the realization that a general sales tax levy actually did not discriminate against interstate commerce, but merely required interstate commerce to shoulder a fair proportion of the tax burden. Where heretofore the very mention of "interstate commerce" in connection with any tax case seemed to be a sufficient barrier to the imposition of a tax, a more pragmatic view seems to have been adopted in the *Berwind-White* case, for the *effect upon interstate commerce* was made the measure of the legality of the tax rather than the purely technical legal distinction which had become so thoroughly a part of the earlier decisions.

In the *Berwind-White* case the vendor maintained a sales office in the City of New York and sold coal, which of necessity came from Pennsylvania mines, to New York City vendees. It took orders for the coal in the City of New York and delivered the coal to the vendees in that city. The Supreme Court found that such transactions were subject to the New York City sales tax, despite the fact that the contracts made it mandatory that the coal be shipped in interstate commerce. The court found that the imposition of the tax did not violate the interstate commerce clause, and in commenting on the point said in part:

> "It was not the purpose of the commerce clause to relieve those engaged in interstate commerce of their just share of state tax burdens, merely because an incidental, consequential effect of the tax is an increase in the cost of doing business."[25]

The Corporation Counsel of the City of New York, in its brief in the Supreme Court, pointed out that the vendees of the Berwind-

[23] 292 U. S. 86 (1934).

[24] 309 U. S. 33 (1939).

[25] *Ibid.* at 46.

White Coal Mining Company would nevertheless be subject to the New York City sales tax in the event that the court held that the city could not constitutionally require collection of the tax by the Berwind-White Coal Mining Company.[26]

It was the city's position that the only burden imposed upon the Berwind-White Coal Mining Company, and, necessarily, upon interstate commerce, was that of collection. It has already been seen that this requirement of collecting the tax is not a burden upon interstate commerce.[27]

Many authorities interpreting the effect of the *Berwind-White* decision are now of the opinion that "there is no longer the need for use taxes that formerly existed." [28]

The City of New York, in conformity with the *Berwind-White* decision, has ruled that all vendees of property purchased from out-of-town vendors who do not maintain a local sales office, are required to pay a sales tax directly to the city; the question of maintaining a local sales office is only important in determining whether a vendor would be required to *collect* a sales tax. Those out-of-state vendors who are subject to the collection provisions of the use tax are now, in line with the *Berwind-White* decision, required to collect the sales tax.

With all of the foregoing in mind, the only type of transaction which the use tax would reach would be one where the vendee takes actual delivery outside the limits of the taxing jurisdiction and returns to that jurisdiction with the merchandise which is used therein. Admittedly some points are still open for consideration on the subject of requiring collection of the use tax by out-of-town vendors who have no places of business in the City of New York. The *Berwind-White* case left this a moot point. Recently, the Supreme Court has held that a mail-order house, with an office in a taxing state is required to collect the use tax on orders sent by mail to its office in the foreign state, irrespective of the fact that the local office was in no manner instrumental in obtaining the order for the merchandise purchased.[29]

It is a matter of interesting conjecture whether the courts will permit an imposition of a use tax if the only activity within the taxing jurisdiction is the solicitation of orders by agents or salesmen sent from without the jurisdiction. As a practical considera-

[26] Title N, chapter 41, section 2.4, of the Administrative Code of the City of New York (Sales Tax Law): "Where the purchaser has failed to pay and a vendor has failed to collect a tax . . . , such tax shall be payable by the purchaser directly to the Treasurer . . ."

[27] See notes 22 and 23, supra.

[28] Waters, *Use Taxes and Their Legal and Economic Background*, University of Kansas School of Business, June 1940.

[29] *Nelson* v. *Sears, Roebuck & Co.*, 312 U. S. 359 (1941); *Nelson* v. *Montgomery Ward & Co.*, 312 U. S. 373 (1941).

tion, in such an instance where the use tax rather than the sales tax would come into play, the information concerning consumer purchases would be most difficult to obtain without considerable policing and much in the way of obnoxious and costly investigation.

It is conceded that in certain instances, as for example, the purchases of automobiles, this problem does not exist, for such vehicles have to be registered and licensed in the taxing jurisdiction. Information concerning the purchases of such a nature is very easily obtainable. This is likewise true where conditional sales contracts and chattel mortgages are recorded. Except in such instances, however, enforcement of the use tax is virtually impossible.

The view is entertained by some of the leading tax authorities of the country that a use tax is onerous because it is believed to constitute a trade barrier between the states, thereby hampering the free flow of merchandise in interstate commerce.

The sales tax is becoming an essential part of the fiscal structure of many of our states; the compensating use tax has become a correspondingly important measure, complementing the sales tax in protecting local business from interstate trade. Unfortunately, however, the use taxes in the individual states vary with regard to exemptions applying to transactions upon which a sales tax has been paid in another state.[30] It is this variance which presents itself as a possible barrier to interstate commerce and which is believed by some to be a discrimination against interstate commerce.

The contrary attitude of the Supreme Court towards this type of discrimination is manifest by its attempts to devise formulae in cases where gross receipts, derived from transactions in interstate commerce, are sought to be taxed by states or municipalities.

The Supreme Court in the *Western Live Stock* v. *Bureau of Revenue* case[31] upheld a privilege tax imposed by the State of New Mexico and measured by gross receipts, despite its apparent inclusion of receipts from interstate commerce. The present Chief Justice, speaking for the court, said that:

> "The tax is not one which in form or substance can be repeated by other states in such manner as to lay an added burden on the interstate commerce. . . . The dangers which may ensue from imposition of a tax measured by gross receipts derived from interstate commerce are absent."[32]

[30] Only seven states, viz., Kansas, Michigan, Mississippi, New Mexico, North Dakota, Oklahoma and Utah, permit an exemption or credit under their use tax laws for property already taxed by a foreign jurisdiction. Research Institute of America, *Sales Taxes and Use Taxes*, September, 1941.

[31] 303 U. S. 250 (1938).

[32] *Ibid.* at 260.

The same court had previously thereto invalidated gross receipts taxes for want of apportionment for the reason that receipts from interstate commerce were included in the tax base.[33]

Local privilege taxes have even been sustained where, included in the base of the tax, were interstate receipts and no apportionment formula was present.[34]

It would appear that the courts are inclined to validate all taxes requiring interstate commerce to pay its way, provided that it is not called upon to pay more than its way.

The logical conclusion to be drawn from analysis, particularly of the cases involving gross receipts taxes, is that the courts are now willing to give the green light to the taxation of interstate commerce by individual states, providing that such taxation does not impose a heavier burden on interstate commerce than that which is imposed on purely intrastate business.

It is, therefore, unfortunate that use taxes in the individual states vary with regard to the exemptions applying to transactions upon which a sales tax has been paid in another jurisdiction.[35] Certainly the amount of revenue being derived from taxes in such a situation is not commensurate with the risk that is being borne by hazarding a type of discrimination which the courts will not condone. What constitutes a true tariff barrier between the states is something which is not the subject of this paper. However, it can readily be seen that in those instances where a purchaser who already has paid a sales tax in the state in which the merchandise was purchased is subsequently required to pay a use tax in the state of use, such purchaser cannot help but feel that he is being discriminated against and as a result thereof will, should the occasion arise, hesitate before making purchases elsewhere than in his own state. It is rather obvious that should such action become widespread, business between states will be somewhat curtailed. The problem must therefore be openly and frankly faced by tax administrators who have the burden placed upon them of finding some method of alleviating this inequality.

One method which I might suggest is that of a compact between the states having sales and use taxes. The Constitution of the United States provides for such compacts.[36] Of course, I can see where such a remedy might be considered by many to be impractical

[33] *J. D. Adams Mfg. Co.* v. *Storen*, 304 U. S. 307 (1938); *Gwin, White & Prince, inc.* v. *Henneford*, 305 U. S. 434 (1939).

[34] *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U. S. 33 (1939); *O'Kane* v. *New York*, 283 N. Y. 439 (1940).

[35] See note 30, supra.

[36] Article I, Section 10, Clause 3: "No State shall, without the consent of Congress, . . . enter into any Agreement or Compact with another State . . ."

by reason of the fact that the consent of Congress is necessary before compact between the states can be entered into. The plan, however, is not unique, for several compacts already have been entered into between individual states as is evidenced by the joint management of the Port of New York, by the States of New York and New Jersey. A further example is the recent compact among twenty-three states, pertaining to the marketing of petroleum. Of course, such a complex step would not be necessary if the various jurisdictions imposing sales and use taxes adopted uniform statutes.[37] Such a statute should provide for an exemption or credit for property already taxed by another state.

The use tax as a revenue-producing factor is relatively unimportant, as can be seen by a comparison of the sums collected on sales and use taxes having the same scope.[38]

The primary importance of the use tax is that it closes the door to potential tax avoidance. Taxing administrators will generally agree that the revenue collected solely because of the use tax is comparatively small. Its real effectiveness is found where stringent enforcement of the tax in effect results in substantially larger collections of the sales tax.

To advocate, as some do, that the use tax should be generally abolished would be absurd; for as an effective weapon against sales tax avoidance it has secured for itself a most valuable place in the American economy. At the present moment, with worldwide events occurring so swiftly that it is only with the greatest difficulty that we, as bystanders may perceive the pattern they are shaping for our future, it is of significant importance that the American economy which is best expressed through American business generally, should find within its scope a taxing program which will result in a continuation of revenue to the states and municipalities in which such business is carried on.

With the increase of business which is appreciably noticeable these days by reason of the great boom caused by the National Defense program, state and local revenues are bound, under a combination of sales and use taxes, to increase multifold. However, we must recognize that the day is coming when the defense boom will have become dissipated, leaving in its wake what many fear will be a depression far greater than we have ever known. A substantial reserve must be set up in our taxing jurisdictions for such a contingency. States and municipalities should have sufficient moneys put away to take care of such relief demands as may arise through

[37] E.g. Uniform Sales Act; Uniform Negotiable Instruments Law.

[38] City of New York Collections Statistics for the period from October 1, 1940 to September 30, 1941 show comparison between sales and use tax collections: Sales Tax ...... $60,388,000 (includes arrears, about 7½%)
Use Tax ...... 1,233,000.

another post-war depression. There should be sufficient financial reserves to provide for a program of public improvement which would, of necessity, bring about continued employment. There should be sufficient moneys set away so that the transition from war-time boom days of a false prosperity to a post-war period of abnormal depression may take place without unnecessary sufferings that otherwise are bound to come.

There is responsibility upon all to whom the affairs of state and local governments have been entrusted to see to it that post-war days will find such jurisdictions on as firm a financial basis as that upon which they are now, for the most part, resting. Sales taxes and use taxes are tried and proven effective means of raising revenue. Their places in the economic structure of America are definite and pronounced.

TWELFTH SESSION

TUESDAY, OCTOBER 14, 7:45 P. M.

Ballroom, Lowry Hotel

Karl G. Neumeier, presiding.

CHAIRMAN NEUMEIER: The meeting will please come to order.

Very, very many years ago, a very eminent authority said, "To him that hath, more shall be given." That was many years ago, and since that time members of Congress and the different legislatures in their infinite wisdom have reversed that old policy, and we now say, "From him that hath, shall be taken away," and that is the subject of tonight's discourse. A more formal topic is the subject of estate, inheritance and gift taxes.

The first speaker of the evening is Dr. Eugene E. Oakes, of the Department of Economics, Yale University, who will speak on the subject, "Revision of the Federal Estate Tax."

Dr. Oakes is a graduate of Harvard University, and taught there for several years. Surprisingly, Yale, recognizing the great ability the Doctor has, employed the Doctor, and he is now on the Yale staff, the faculty of Yale University, which is quite a recognition, I think, for Yale to make to a Harvard graduate. Therefore, I take very great pleasure in introducing at this time Dr. Eugene E. Oakes.

EUGENE E. OAKES: May I say at the outset that I shall not refer in my remarks to the federal-state jurisdiction problem. Twenty minutes is a short space of time to deal with the federal estate taxes alone, but I want you to know that I am well aware of the fact that any revisions which are made in this particular law have to be made with respect to the effects that they will have upon state legislation. Unfortunately, I can't go into that aspect of the general problem in the time that is at my disposal.

In a period like this, when a tremendous increase has taken place in federal expenditures, no taxes, however small in their revenue-producing capacity, can be overlooked. The federal estate and gift taxes, while they are not major proportions of the federal revenue structure, do produce substantial revenues, revenues that approach five percent of the total federal income from taxation, and therefore it is appropriate to look at them with respect to the possibility of raising additional revenues from them now.

THE REVISION OF THE FEDERAL ESTATE TAX *

EUGENE E. OAKES
Yale University

Rocketing expenditures are enforcing a thorough review of the federal tax structure and in this process a pair of levies which accounts for nearly 5% of the total yield cannot be expected to escape attention.[1] True, the taxes on the transfer of estates and gifts are not well suited to emergency use. Substantial historical precedent for such action exists, but the fact remains that these taxes do not fit the logic of a well-conceived system of emergency finance designed for use in a period of armaments boom. Neither tax has any real bearing on the process of shifting the nation's resources from civilian to armaments production; nor can either be expected to act as an efficient instrument for reducing consumer expenditures when the latter threaten to get out of hand.

Collections lag far behind the date when the tax is imposed. This is particularly true of the levy on estates which is not due until fifteen months after the date of death and the payment of which can be postponed for an additional period up to ten years in the event the estate can show that earlier payment would involve unusual hardship. A lag of this sort means that specific changes in the taxing act intended to produce new revenues for emergency use will bring their results only after an extended interval, perhaps not until the period of most intense need has already passed.

In addition to this technical weakness a temporary variation in rates or in the details of these taxing acts is objectionable in its own right. Measures of this sort involve unreasonable discrimination between individuals and an excellent *prima facie* case exists for maintaining a rate schedule and a tax law which will not be changed drastically or at frequent intervals.

This does not mean that revision of the estate tax is inappropriate at the present time, but rather that any changes ought to be regarded as permanent revisions intended to survive the emergency. If changes of this sort are indicated, and if additional revenue is involved, the extreme pressure on the federal tax system provides a strong incentive for taking action now. From this point of view it is highly expedient to review the details of the estate tax seeking out loopholes which might be plugged, and unnecessary, possibly unwise, concessions which are being made as a matter of policy.

* The limitations of space imposed on this paper prevent any reference to the extremely important question of the relation between federal and state taxes which is involved in a revision of the federal law.

[1] In the fiscal year 1941 the yield of the gift tax was $51,864,000 that of the estate tax $355,194,000, a total of $407,058,000. The most recent estimate for the fiscal year 1942 is a total yield of $451,000,000.

Above all it is appropriate to raise again the question of the wisdom of the rate schedule and the specific exemption used in the present law.

Basic to the construction of this tax is the concept of the gross estate and a search for possible loopholes should begin here. While the tax is imposed primarily upon testamentary transfers and those made under laws of intestacy, the gross estate also includes six other items associated with the fact of death. Three of these appeared in the original law, the act of 1916.[2] They are: transfers *inter vivos* taking effect in possession or enjoyment at or after death, (b) *inter vivos* transfers in contemplation of death; and (c) transfers under rights of survivorship in assets held by a multiple tenancy. The loopholes remaining open in the first and the last of these categories are minor and need not detain us here,[3] but the same conclusion is not warranted with respect to the gift in contemplation of death. The best that Congress has been able to do by way of stopping avoidance along this route is to raise a rebuttable presumption that transfers made within two years prior to death are of this variety, and when this presumption fails to impose a gift tax. The basic difficulty is the fact that the courts view contemplation in terms of intent which is hard to establish in any event while in this instance the necessary evidence is better known to the estate than to the government, and the former is frequently in a position to conceal or distort portions of the available data. The administrative difficulties encountered suffice to render the contemplation of death clause ineffective except in those cases where the presumption applies, and even here the government's success in upholding its own interpretation of the facts under review is by no means impressive. A stronger version of the presumption clause was once a part of the federal law[4] but failed to survive the constitutional hurdle,[5] and hence the chief potential obstacle to avoidance along this route is the levy on gifts.

In the form which it now takes the latter is only a partial deterrent. The rates are lower than those applied under the estate tax,

[2] Sec. 202, 463 Laws 1916.

[3] Minor loopholes remain such as the device used to circumvent the ruling that a trust in which the donor retains income for his life is a part of his gross estate. In these cases the donor may escape by making a complete gift of the assets involved and at the same time entering into a contract under which the beneficiary agrees to pay the donor an annual contribution which is the equivalent of the income that the assets produce. Success in this manipulation depends on the complete separation of the two portions of the agreement.

In the case of tenancies the chief potential loophole is the tenancy in common only half of which is taxed on the death of one of the tenants. However, the scope of this device is severely limited by the restrictions placed on this form of tenancy under the laws of most states.

[4] Sec. 302 C, 27 Laws 1926.

[5] *Heiner* v. *Domman*, 286 U. S. 312.

and the exemptions as well as the bases upon which the two levies are imposed are calculated independently. A really effective check on avoidance by gifts *inter vivos* would require the integration of the gift and estate taxes by the cumulative calculation of the tax due with a formula similar to that now being used in the levy on gifts. The chief obstacle to revision of this sort is a well-entrenched prejudice in favor of the *inter vivos* distribution of wealth.

The three remaining transfers on the list specifically included in the gross estate appeared for the first time in the act of 1918. They are transfers made (a) under a "general" power of appointment, (b) under the rules of dower and curtesy or the statutory equivalent, and (c) under a life insurance contract. While the limiting adjective "general" opens a loophole of a minor sort in the clause dealing with powers of appointment, our attention had better be concentrated on the marital rights and the insurance contracts.

The specific inclusion within the gross estate of transfers under marital rights existing in common law states ended a situation in which the taxability depended on the technical details of the property law of the state where the transfer occurred. Geographical uniformity was achieved by this action so far as the common-law states were concerned but unfortunately the action taken in 1918 did not apply to marital rights in the so-called community property states.

In the latter current accumulations which do not arise out of so-called separate property are regarded as vested to 50% in the hands of the wife and 50% in those of the husband.[6] As a result only half the assets accumulated by the joint action of the marital community is taxable at the death of either spouse. Taken in conjunction with a substantial exemption and sharply progressive rates, this produces violent discrimination in favor of estates passing beneath this system of law.

Possible remedies for this important and irritating flaw in the present estate tax range from a generalization of the treatment now accorded residents of the community property states to the abandonment of the basic system of property law used in these jurisdictions. The latter is of course an extremely remote possibility and the former raises a new set of problems involving the readjustment of the rate schedule and the treatment accorded married as contrasted with unmarried taxpayers, which are similar to those precipitated by the recent proposal to require joint returns under the levy on incomes.

The most likely solution to the community property problem is the discovery of a property right which passes at the time of the death of one of the spouses and which would make it impossible to tax all of the community property at that juncture. This probably means a tax on the power of management all of which is normally

[6] Prior to 1927 the wife did not have a vested interest in her share in California.

in the hands of the husband and does pass from him at the time of his death. If that power could be made the basis for a tax, the geographical discrimination could be avoided. Unfortunately no precedent for such action exists and no case can be cited in which the power in question taken alone supported a transfer tax. But the importance of the problem, the difficulty of alternate solutions, and the reconstruction of the federal Supreme Court make an attempt along those lines well worth trying.

Equally troublesome are the problems associated with the insurance contract. Here there are two major issues: (a) the possibility of taxing insurance on the life of the decedent which is not payable to his estate and in which he retains none of the so-called "incidents of ownership," and (b) the continuance of the special $40,000 exclusion now granted to savings accumulated in the insurance form.

Until recently the answer to the first of these questions seemed to be in the negative. If the insured retained no "substantial incident, such as the right to alter or revoke, no transfer took place at the time of death upon which the tax could be imposed.[7] An attempt had been made to tax contracts of this sort on the basis of another criterion, the payment of premiums by the insured, but the courts proved unsympathetic and the experiment was abandoned.[8] Recently the government has tried the same tactic again.[9] If it succeeds, which is not too likely, a great deal of additional insurance will become taxable and a loophole of substantial proportions will have been closed. If the attempt fails, the most likely substitute is a special tax on the transfer of insurance,[10] but this is not nearly so satisfactory since it is doubtful whether the tax could be made to vary with either the size of the insured's estate or the total amount which the beneficiary receives as a result of the death of the insured. If the tax cannot be constructed in this fashion the remedy will be partial in nature as the present gift tax is a partial remedy to avoidance by a transfer in contemplation of death.

In sharp contrast is the problem presented by the $40,000 exclusion which is made purely and simply a matter of policy, and hence can be withdrawn at the will of Congress. The arguments raised in favor of this exclusion boil down to the thesis that there is no increment at the time of death, that the funds received do little more than compensate for the loss of the decedent's earning power, and a similar argument to the effect that a tax on insurance is a tax on

[7] A wealth of authority for this statement is available. See esp. Clark, K. R., *Inheritance and Estate Taxes on Life Insurance*, p. 53; Paul, R., "Life Insurance and the Federal Estate Tax," 52 *Harvard Law Review* 1037-76, and Fraenkel, O., "Federal Taxation of Life Insurance Policies," 5 *Brooklyn Law Review* 140-144.

[8] *Regulations 80*, Art. 25 (1937 ed.).

[9] T. D. 5032, Jan. 10, 1941.

[10] Paul, *loc. cit.*, p. 1055.

a tax because insurance is merely an accumulation intended to provide for a future need. Neither argument really establishes a case for the special treatment of this particular form of savings, and the same conclusion may be drawn concerning the repeated suggestion that an accumulation of insurance be permitted outside of the gross estate in order to provide a fund for use in payment of taxes. The only really satisfactory justification for the present exclusion would be the establishment of the idea that insurance is a peculiarly desirable method of saving from a social point of view. Because of the development of government insurance schemes as well as the limited scope and peculiar distribution of the holdings of private insurance, this particular tactic does not really warrant serious consideration. Hence a clear case exists for deleting the concession now being granted.

In addition to the gross estate, the calculation of the tax requires the application of an extensive set of deductions, the most significant of which in the present connection are the two made purely and simply as a matter of policy. These are the deductions permitted on the basis of prior-taxed property and the so-called charitable or public bequest.

The prior taxed property clause is easy to justify since it is an attempt to make the estate tax less discriminatory as between fortunes of a specific size. No surety exists that, even in the event the rates and the details of the tax law remain constant over time, the discrimination resulting from a variation in the frequency with which particular assets are transferred will average out in the long run. Hence the only question of policy which remains is the form which the concession ought to take. It is highly likely that a tax credit would be an improvement on the present deduction, and that the size of the credit ought to depend more directly upon the length of the interval between the specific transfers, but it would be an error to look upon a revision of this clause as a source of additional revenue.

Unfortunately the same conclusion must be drawn with respect to the deduction for public and charitable bequests, and this is so in spite of the extreme difficulty which anyone encounters who wishes to justify with logic the concession now being made. These deductions are calculated to influence the testator in the disposition of his assets by permitting certain courses of action to reduce his tax load.[11] In this fashion the accumulation of funds by the preferred beneficiaries is subsidized at the expense of federal revenues as well as those of the states which have based the rates used in their death duties on those applied under the federal law. The amount of the

[11] It is worth noting that the saving in taxes frequently is more than the amount of the tax on the deduction permitted. The reduction of the net estate involved in this deduction is quite apt to produce a lower effective rate of taxation.

subsidy is highly unpredictable since it depends on the number of people actually influenced by the existence of the concession, which is largely a matter of the efficiency with which the interested parties can use the deduction as a selling point in approaching possible beneficiaries, and upon the amount of the additional tax which the latter would otherwise have paid. This is indeed an erratic form of subsidy and when its concealed nature is taken into account a clear case appears for the substitution of outright assistance to the favored agencies. The latter could object to this change on two grounds only: that it would mean in fact a withdrawal of the subsidy, which is a devastating admission of weakness; and that the change would produce undesirable legislative interference with matters of policy, which is an admission of lack of faith in the democratic process.[12]

But the basic issue is the existence of a subsidy in any form and strong arguments can be made in favor of the complete deletion of most of the concessions now granted. Unfortunately the enterprises in question have become dependent on the aid received and many are in such financial difficulties that the removal of concessions of this sort would hasten their complete collapse. Hence the deletion of the charitable deduction from the death duty may be recommended in the interest of more careful budgeting of the public finances, but existing circumstances would probably require the construction of another subsidy which would it is true be of a more desirable sort but nevertheless would make highly unlikely the appearance of a net addition to the revenues available for general use.

Unfortunately, even a drastic campaign of loophole plugging along the lines indicated above probably would not provide really large quantities of additional revenue. In fact the extent to which avenues of avoidance have already been stopped means that the raising of large amounts of new income from the estate tax is primarily a question of the rates applied and the specific exemption allowed. Now it so happens that the existing tax is characterized by a high exemption, by small rates in the lower brackets, and by punitive taxation of the very large fortunes, all of which reflects an intent to use the tax primarily as an instrument for the redistribution of wealth.[13] This in turn complicates the task of passing judgment upon the wisdom of rate changes in the immediate future.

[12] It might also be argued that a direct subsidy would be more expensive to administer, but in view of the number of highly technical disputes which have already been brought out in the courts over the "charitable" deduction the argument appears to have little weight. Even granting its validity, this consideration is not important enough to overcome the arguments in favor of more direct methods of subsidization.

[13] This intent was clearly expressed by President Theodore Roosevelt as early as 1906, was obviously the primary motive activating the farm bloc in its campaign for higher rates during the 1920's, and is clearly reflected in the rate changes made in 1932, 1934, and 1935.

To some extent the problem can be simplified by dealing separately with the proposal to raise rates in the lower brackets and to reduce the exemptions, that is, "to broaden the base" of the tax. An impressive argument can be raised in favor of such action even though the alternative is an income tax on the same group of taxpayers on the ground that the effect of a death duty on these estates has no very serious repercussion on the volume of national savings or investment, and that the effect on initiative would probably be less than in the case of an equivalent levy on net incomes.[14]

But the more important issue, the rates imposed on the great fortunes, cannot be disposed of so easily. Strong opinions to the effect that existing rates are too high or too low are very easy to find, and at least three decades of fairly continuous debate have produced a familiar and reasonably clear-cut set of conflicting arguments.

Advocates of lower rates are no longer likely to argue in terms of the natural rights of property, for natural rights have gone out of fashion. On the contrary the conservative position is more apt to be taken on strictly economic lines, very similar to those which Andrew Mellon used when he tried to obtain the repeal of the estate tax during the twenties. Three major assertions are commonly made: (a) that the high rates reduce savings, which is regarded as unfortunate because it slows down the growth of technical equipment and hence reduces the future increase in national output; (b) that high rates stifle the motives which lead men to take speculative business risks where long odds are matched by the hope of big killings, and this like the effect of savings is supposed to reduce the future standard of life of the masses of the people; and finally (c) that the heavy rates force the liquidation of large amounts of securities and hence tend to depress security values generally.[15]

Prior to 1929 the advocates of higher taxes were apt to place primary reliance on social reform rather than strictly economic considerations, but the impact of the great depressions of the 1930's has added powerful economic arguments to their arsenal, arguments which appear in their clearest form in the writings of Professor Alvin Hansen.[16] If accepted these will cut the ground from under the chief props beneath the conservative position leaving no major objection to punitive taxation of large fortunes other than the difficulty of liquidating the estate in order to pay the taxes due.

The Hansen argument is based on two major theses: first, that in the future our society will normally save more than can be in-

[14] Pigou, *A Study in Public Finance*, ch. 13.

[15] For the Mellon arguments see Mr. Mellon's book, *Taxation, the People's Business*.

[16] See esp. *Fiscal Policy and Business Cycles*.

vested effectively, and second that the expectation of large profits is not really a major incentive to speculative investment.

Any economist who would pass judgment on a proposed increase in the taxes levied on large fortunes and would not do so purely on the basis of prejudice or social sympathies must take the Hansen argument seriously. Unfortunately, I do not believe very much can be done to determine the validity of these arguments with the facts now available. The thesis that savings had better be reduced rather than encouraged depends on the existence of a stagnant sort of economy in which investment opportunities are extremely rare. An anticipation of this sort must now be based mainly on conjecture; only time and the evolution of industrial technique will provide a real answer.

The economist's position on the importance of large profits as an incentive to speculative investment is even more unpleasant. Here the facts of the matter are obviously very complex, little known and difficult to discover. In short, a clear-cut decision based upon strictly economic considerations is not possible at the present time. This means that in the future as in the past the rates applied in the upper brackets will be the battle-ground of conflicting class interests. Moreover, it is highly likely that economic considerations will play a smaller rôle in the future when violently conflicting approaches to economic policy are struggling for supremacy, than they did in the past when the rank and file of economists was using a set of ideas which raised a strong presumption against the application of punitive rates intended to redistribute wealth.

CHAIRMAN NEUMEIER: Thank you, Dr. Oakes, for your very excellent paper.

The next speaker on our program this evening is our own Philip Sherman. He is a member of the staff of the Attorney General of the State of Minnesota. At the last session of the legislature he devoted himself quite largely to interpreting the intricate tax laws and bills that came over from the House of Representatives, so that I could understand them. I found him very well versed in the subject, and very helpful. He is a man of very pleasing, genial personality. Everybody likes him. He is very pleasant, and very plausible in his arguments. Even the taxpayers of the State of Minnesota are happy to pay taxes here, even though we always lose against him.

I am sure you will enjoy hearing a man of that caliber, and I take very great pleasure in introducing to you my very good friend Philip Sherman.

PHILIP SHERMAN: Mr. Chairman, you will notice that when our Chairman was introducing Dr. Oakes, he remarked that he wished that he had had the benefit of the experts who are here at this association meeting when he was working on his tax legislation at

the last session. You know really what he thinks about the advice that he had at the last session.

I heartily agree with Senator Neumeier, and I wish that this Association could be in session in St. Paul about the last day of the next legislative session, and be on call at any hour of the day or night, so as to help out in our next tax legislation.

THE INTEGRATION OF GIFT, INHERITANCE AND INCOME TAXES

PHILIP SHERMAN

Assistant Attorney General, Minnesota

Less than a year ago Judge Magruder of the First Circuit Court of Appeals said, in closing his opinion in the *Prouty* case,[1] "It may be frankly recognized . . . that the interrelation of the income, estate and gift taxes presents many puzzling problems . . ."

The purpose of this paper is to discuss very briefly some of these problems. The entire subject has been so thoroughly covered, however, within the last year or two, by authorities including Professor Nash,[2] Professor Magill,[3] Mr. Cahn of New York[4] and my associate Mr. Stevens before the Tax Administrators at Lexington last summer, and others, that the only task remaining for me is to bring together for your benefit, and bring up to date, various proposals and possibilities of more closely coordinating the three types of tax.

It is, of course, not remarkable that the legislatures, in enacting death, income, and gift tax laws, have considered them as separate taxing measures, but it is somewhat surprising to note the extent to which this "disintegration" has been allowed to continue. In some states the separation has been carried to the extreme of imposing the duties of administering the death tax, and the income tax, upon two separate and distinct officials, neither responsible to the other nor to any common superior. Prior to 1941 there were at least eight states in which this situation existed, and at the present writing six remain.[5] In these states, presumably, there is no coordination in the administration of the two types of tax; and it is at least theoretically possible for both taxpayers and administrators to take entirely inconsistent positions, as for example in valuations of the same property, and in deciding whether the same payment is taxable income, or corpus for estate tax purposes, or whether a payment to an employee is a gift or salary. The tendency throughout the coun-

1 115 Fed. (2d) 33.

2 18 *Taxes* 265.

3 40 *Columbia Law Review* 773.

4 29 *Georgetown Law Journal* 677.

5 California, Louisiana, Maryland, Missouri, New Hampshire and Oregon.

try is apparently to follow the example of the federal government to the extent of integrating at least the administration of the taxes, and the procedure of assessment and review.

After considering the absence of integration even in administration, let us jump to the other extreme and go as far as we can into the realm of possible complete integration, before coming back to realities. Complete integration of all three taxes has not been seriously proposed in recent years by anyone, so far as I have been able to discover. It would involve imposing one tax upon all property received, whether by way of bequest, gift, dividends, salary or otherwise. The inclusion of gifts and inheritances in an income tax may seem startling, but Congress enacted exactly that provision in 1894.[6] Such a statute, if enacted today under the name of an income tax, would undoubtedly fall by reason of the definition of income in *Eisner* v. *McComber*,[7] and if an act of Congress, it might have to be apportioned as a direct tax.[8] On the other hand, it might be possible to work out a valid law by an application of the language in *Helvering* v. *Bullard*[9] to the effect that since Congress had the power to levy an excise upon gifts, it could do so whether the tax was named an estate tax or a gift tax. Thus it might be argued that if Congress and the states have power to levy excises on the privilege of succession to, or the right to receive, money or property, the tax may be imposed by one law, whatever the nomenclature.

There is no doubt that such a completely integrated system of taxation would have some advantages. Taxpayers would include in one return all money and property received. There is nothing invalid in the treatment of the same property as both corpus and income.[10] Adjustments might be made in the rate and exemptions as between money received by way of gift and inheritances on the one hand and income on the other. Much of the present litigation would be eliminated. Notwithstanding the theoretical advantages, I venture to suggest that complete integration, enacted into law by Congress in 1894, is not so imminent now as to justify giving it any further consideration when there are more practical problems confronting us.

Between any two extremes there is of course a middle ground. Although, as we have just seen, the integration of the death tax with the income tax is more or less revolutionary, proposals to integrate the death and gift taxes are familiar to you all. Such integra-

[6] 28 Stat. 553.

[7] 252 U. S. 189.

[8] Compare *Bromley* v. *McCaughn*, 280 U. S. 124; Magill, supra, 40 *Columbia Law Review* 773.

[9] 303 U. S. 297.

[10] *Bull.* v. *U. S.*, 275 U. S. 277.

tion was suggested by the treasury some years ago. It was discussed by Mr. Altman of California, in an article in May, 1938,[11] again at the San Francisco meeting of this Association two years ago,[12] and in a further article a year ago last spring;[13] Professor Magill;[14] Professor Brandis;[15] Mr. Cahn;[16] and others, have seconded the proposal, and Mr. Merry of Michigan has suggested coordination rather than integration.[17] It would serve no purpose here to discuss in detail the problem so thoroughly covered by the authorities just mentioned. It is sufficient to remind you that in substance the proposal is to eliminate all the present technical and sometimes hairline distinctions between gifts in contemplation and gifts not in contemplation, and between transfers intended and transfers not intended, and to eliminate likewise all the laborious attempts at tax avoidance which result in countless disputes and endless litigation, by combining the two taxes into one, and imposing an excise on all completed transfers without valuable consideration, treating the transfers by reason of death as the final transfers, and computing the tax at death and progressive rates which take into consideration all previous gifts. As Mr. Altman and Mr. Cahn both point out, the constitutionality of such integration could probably be established.[18] There is no reason why it could not be applied to state legislation. Mr. Altman suggests that rates could be adjusted so that the imposition of the tax upon transfers inter vivos would compensate for the time factor between then and the time of death, making it of little importance whether the tax was paid at the time of the gift or postponed until the time of death. The only criterion, under such a law, in determining whether a tax was payble on a transfer during life, would be whether or not the transaction was complete. To the extent that the rate and exemption structure created any advantage as between transfers complete when made and those taxable only at death, there would still be an incentive to litigate; but it is obvious that the burdens both of the administrator, the taxpayer, his counsel, the courts, and the administrative tribunals, would be greatly decreased. It would seem that the same result could be accomplished by amending the present statutes, with respect to the definition of transfers, and with respect to rates and exemptions, without actually repealing either or both of the existing types, and enacting an entirely new and untried excise tax law.

[11] 16 *Tax Magazine* 259.

[12] *Proceedings Natl. Tax Assn.*, 1939, 416.

[13] 7 *Law & Contemporary Problems*, 331.

[14] 40 *Columbia Law Review* 773.

[15] 19 *N. C. Law Review* 304.

[16] 29 *Georgetown Law Journal* 677.

[17] 38 *Mich. Law Review* 1032.

[18] See *Helvering* v. *Bullard*, 303 U. S. 279.

Notwithstanding the fact that such a proposal seems to be universally approved, and that the only objection is that tax avoidance would be more difficult if not impossible, the result has not yet been accomplished by any legislation. Even the two states [19] which added the gift tax to their laws in 1941 followed the historic pattern. Perhaps there is a feeling on the part of legislators that not every avenue of escape from the taxation of one's property at death should be closed. The loopholes which have appeared from time to time have been so promptly stopped up by amendments, however, that we would be justified in concluding that the accomplishment of the final step is at least within the realm of possibility.

In the absence of any legislative action, state or federal, is there anything in existing law, or in its administration, which could be termed an approach toward "integration"? So long as the different types of laws are separate and distinct on the books, each tax must, of course, be assessed and computed under the applicable statutory provisions; but that does not mean that in determining the liability for one tax, consideration should not be given to the question of consistency as between that and others, interrelation having been, as we have seen, so widely recognized. To be entirely consistent, as between gift and death taxes, it would of course be necessary to provide that all transfers, to the extent taxable under the gift tax, are excluded from the death tax, and likewise, if incomplete for purposes of gift taxation, are includible in the estate at death. Again, to achieve complete consistency, it would be necessary to provide that if a transfer is held complete for gift tax purposes, the income from that property is not taxable to the transferror, and on the other hand if the transfer is held not complete for gift tax purposes, the income therefrom is properly taxable to the giver. Such complete consistency has not been attained either with respect to gift and death taxes, or with respect to transfers and income taxes. Oregon does provide [20] that property taxable as a gift is not includible for purposes of the death tax. Generally, in administering the laws, there is appreciable progress toward coordination, and the question is receiving more and more attention from judicial and other authorities.

Let us consider first the gift and estate taxes. Comparing the federal statutes, we find that substantially different tests have been provided. In *Burnet* v. *Guggenheim* [21] the court suggested that the draftsman of the 1924 gift tax law might have been more explicit, but held that a transfer incomplete under the specific provisions of the estate tax was likewise incomplete for purposes of the gift tax, until the relinquishment of a power to revoke. After the *Guggen-*

[19] Oklahoma and Washington.

[20] *C.L.A.* 20-201(c).

[21] 288 U. S. 280.

heim case the 1932 gift tax law was amended so as to make it even less explicit, and since the amendment it has contained no statutory definition of what is taxable as a "transfer".[22] The estate tax[23] provides that transfers are incomplete where subject to change "by the decedent or in conjunction with any person." The gift tax regulations now provide[24] that power to change remains in the donor where exercisable in conjunction with "any person not having a substantial adverse interest." Thus a transfer subject to change by the settlor and one *having* a substantial adverse interest is incomplete for estate tax purposes but, by implication, complete for gift tax purposes. The circuit court of appeals has so held in *Commissioner* v. *Prouty*.[25] Regulations 80, as amended September 19, 1940, now contains a provision expressly recognizing the relation between the two taxes. Article 17 interprets the words "intended to take effect at death" in Section 811(c) as including a transfer subject to the possibility of a reverter, but provides that if it was made during the time between the *St. Louis Union Trust* cases[26] and the *Hallock* case[27] it is not taxable *if the full value has been taxed as a gift.*

The courts, following the suggestion in *Burnet* v. *Guggenheim*, have recognized in a number of cases the correlation between the two taxes. For example, in *Hessline* v. *Hoey*,[28] it was held that if a transfer is incomplete to such an extent that upon the transferror's death it will be included in his gross estate, it is not a taxable gift. The Supreme Court later expressed this doctrine in forcible language in the *Sanford* case[29] and expressly stated that the test of completeness in a gift tax case under the 1924 act was intended by Congress to be exactly the same as the test in determining whether the transfer was subject to an estate tax; and held taxable the relinquishment of a power to designate new beneficiaries other than the settlor. However, in *Herzog* v. *Commissioner*,[30] decided January 6, 1941, two months after the *Sanford* case, a transfer in trust, with income payable to the settlor in the sole discretion of the trustees, was held taxable as a gift to the extent of the full value. The settlor advanced, among other arguments, the proposition that since

[22] *I.R.C.* 1000.

[23] *I.R.C.* 811(c)(d).

[24] *Regulation 79*, Art. 3.

[25] 115 Fed. (2d) 331.

[26] 296 U. S. 39, 48.

[27] 309 U. S. 106.

[28] 91 Fed. (2d) 954, certiorari denied, 302 U. S. 756.

[29] *Sanford's Est.* v. *Com'r.*, 308 U. S. 39.

[30] 116 Fed. (2d) 591.

the entire value of the property would be included in his estate at death, a gift tax should not be imposed on the value of the intermediate interests. The court questioned the correctness of the premise, pointing out that the taxpayer did not come within the express provisions of Section 803(a) of the 1932 act, but went on to say that the possibility of an overlap did not preclude the imposition of a gift tax. The court expressly distinguished the *Sanford* case on the ground that there the transfer was incomplete and not subject to the gift tax, whereas in this case the transfer was complete, and subject to the gift tax, notwithstanding the possibility that an estate tax might also be imposed. In other words, the court limited the broad language of the *Sanford* case to the specific facts there involved. The Board of Tax Appeals, however, has still more recently recognized and applied the rule of consistency. In *Robinette*,[31] decided just last June, it refused to include in the measure of the gift tax the remainder interest in a trust where the grantor had retained a possible power of testamentary disposition, and one of the reasons given by the board was that under the *Hallock* case [32] the remainder interest would necessarily be included in the gross estate at death, and this was a "strong reason" for refusing to tax it as a gift. Again, in *Adams*,[33] decided last July, the board refused to tax as a completed gift a transfer subject to the reservation of a life annuity payable out of corpus if the income should be insufficient. The board pointed out that the same factors which determine the applicability of the gift tax determine also the applicability of the estate tax, and reasoned that since the value of the corpus was subject to the estate tax, it should not be included in the measure of the gift tax. Then the federal district court of New York, in *Smith* v. *Shaughnessy* [34] decided last July, applied the rule in the *Sanford* case and cited the *Hallock* case in denying the taxation as a gift of the remainder interest in property transferred subject to the possibility of reverter, but took pains to point out that notwithstanding the language of the *Sanford* case, the two taxes were not necessarily mutually exclusive, and held the irrevocable transfer of the life interest taxable as a gift, although the full value would be taxable at death under the *Hallock* case. Whether consistency will be attained without legislation remains to be seen, and certainly it has not yet arrived.

The state laws, as has already been noted, provide almost universally for a credit of the gift tax against the inheritance tax, indicating an intention that in some cases at least both taxes should be

[31] 44 B.T.A. No. 112.

[32] 309 U. S. 106.

[33] 44 B.T.A. No. 166.

[34] —— Fed. Suppl. ——.

imposed. The Wisconsin Board of Tax Appeals has held,[35] however, that in a gift tax case, decisions under the inheritance tax would govern; and the attorney general of Tennessee, in an opinion dated April 30, 1939, held that a transfer reserving life income was taxable under the inheritance tax and *therefore* was not subject to the gift tax. In North Dakota the attorney general has ruled[36] that where there is a transfer to the grantor and another as joint tenants, one-half of the value of the property is taxable as a gift and the other half taxable to the grantor upon his death. There are undoubtedly other indications of purpose to approach consistency in applying the rules with respect to completeness of transfers in determining both the gift and the death duties. It is clear of course that as long as the concept of transfers in contemplation of death remains in the law, there is bound to be an overlapping. Under the federal law and that of most of the states, this overlapping extends likewise to transfers to joint tenants. Except in these two types of transfers, it would be possible in most cases, with or without some amendment of existing statutes, to achieve fairly complete consistency in determining death and gift taxes.

When we come, however, to a consideration of the relation between death taxes and income taxes, and consistency in applying the law to transfers inter vivos, we find a somewhat different situation. As we have seen, the estate tax law[37] provides that the transfer is incomplete if subject to a change by the donor and any other person. The income tax law[38] taxes the income to the grantor if subject to change by him *or* any other person *not having a substantial adverse interest.* With respect to the requirement of "substantial adverse interest" the income tax act and the gift tax act as interpreted by Regulations 80 are more nearly consistent; but both the gift and estate tax laws require that the power be exercisable by the *donor,* whereas under the income tax law a transfer is incomplete if subject to change by the other person alone, provided he has no substantial adverse interest. The difference in nature of the income and the death taxes has been recently judicially emphasized. In the *Sanford* case[39] decided November, 1939, the taxpayer argued not only that the estate tax provisions should be applied to prevent the imposition of the gift tax, but also the provisions of the income tax law taxing to the settlor the income of a revocable trust. The court refused to say whether the income would be taxable to the settlor if he reserved the power to modify solely

[35] *Miller*, Wisconsin Board of Tax Appeals, March 15, 1940.

[36] April 13, 1939; April 27, 1939.

[37] *I.R.C.* 811(c)(d).

[38] *I.R.C.* 166, 167.

[39] 308 U. S. 39.

for the benefit of others and held that in any event the transfer was complete for gift tax purposes. Then in the *Clifford* case [40] the court emphasized the importance under Section 22(a) of the ownership of the corpus in income tax cases, but held that the income of property which had been transferred in trust, and upon the transfer of which a federal gift tax had been paid, was taxable to the transferror. The circuit court of appeals in January, shortly after the *Sanford* decision, but before the *Clifford* case, in *Graff* v. *Commissioner*,[41] held that capital gains of a trust in which the grantor had a possible reversion with respect to the corpus were taxable to him as income. Relying on the *Klein* case [42] and the *Hallock* case,[43] the court pointed out that while these were not income tax cases, the same rule should be applied, and that if the transfer was not complete for gift and estate tax purposes, an addition to capital by reason of the accumulation of profits under the circumstances of this case should be considered taxable to the transferror. This case is probably an extreme example of the application of the rule of consistency, since the result reached is in conflict with prior decisions,[44] and is based solely on the analogy of estate tax cases.

The Board of Tax Appeals considered the question of consistency in *Martin Beck*,[45] decided two weeks after the *Sanford* opinion was handed down. In that case there was a transfer in trust, the income to be used in payment of premiums on the assured's life, any balance to go to his wife and children. The settlor claimed that since under the income tax law he would be required to pay a tax on that portion of the proceeds applied to insurance premiums, the commuted value of the premium payments should be deducted from the total in computing the gift tax. The board reached the result claimed by the settlor but refused to do so on the reasoning advanced. It expressly pointed out that Congress has not " achieved mutual exclusiveness ". This case has been appealed to the circuit court of appeals for the second circuit.

Other board cases, decided prior to the *Sanford* case, express various views of the relation between the two taxes. In *Estate of Mead*,[46] the board held that where there was a transfer in trust with the power to change the beneficiaries except in such a way as to benefit the settlor, the distributions of income from the trust to the beneficiaries were not taxable as gifts. The majority relied on

40 309 U. S. 31.

41 117 Fed. (2d) 247.

42 283 U. S. 231.

43 309 U. S. 106.

44 See 25 *Minn. Law Review* 958.

45 43 B.T.A. 147.

46 41 B.T.A. 424.

the fact that the income was not taxable to the donor; the minority members pointed out that since the transfer in trust was clearly incomplete for estate tax purposes, it would be more consistent to hold that the payments of income became complete as made. The majority relied on the desire to be consistent as between the income tax and the gift tax, and the minority relied upon the application of the estate tax rule to a gift tax case. An appeal from this ruling to the circuit court of appeals has been dismissed on stipulation.[47] However, a subsequent case involving a similar problem,[48] decided just a year ago, has been appealed to the circuit court of appeals for the ninth circuit. In that case there were reciprocal trusts made by three brothers, the power to revoke being vested in the other brothers and their tax counsel. The court held, following the *Mead* case, that the payment of income from a trust of that nature is not a taxable gift. The government, failing in its attempt to obtain a reversal of the *Mead* ruling, claimed that in this case the income was taxable to the settlor and therefore the *Mead* case should not be controlling. The board refused to decide the income tax question and pointed out that it would make no difference anyway since the *Mead* case does not depend on whether the income was taxable to the grantor. It is possible that the circuit court of appeals, in the decision of this case, will refer to the application of income tax principles to a gift tax decision although the case could well be disposed of without doing so. The *Mead* case has been severely criticized both as to the result and reasoning by Professor Nash[49] and by Professor Magill.[50]

The *Prouty* case, decided by the circuit court of appeals of the first circuit a year ago,[51] held that as to two trusts, created in 1931, the relinquishment in 1935 of a power to revoke with the consent of the beneficiary subjected them to taxation as gifts in that year, since the beneficiary did not have a substantial adverse interest; and as to a third trust, the court held that the transfer was complete before the gift tax was enacted since the beneficiary there had a substantial adverse interest. What is of interest here is the court's reasoning. With respect to the gift tax imposed on the relinquishment of the power, the court indicated that if the opposite results were reached and the trust held complete when created, it might prevent the taxation of the income to the grantor under Section 166 and therefore would "afford obvious facility for tax evasion". With respect to the trust held complete in 1931, the court pointed out that even if the grantor would be subject to the income tax

[47] 116 Fed. (2d) 278.

[48] *Warner*, 42 B.T.A. 954.

[49] 18 *Taxes* 265.

[50] 40 *Columbia Law Review* 773.

[51] 115 Fed. (2d) 331.

under the doctrine of the *Clifford* case [52] the gift tax "does not seem to be so closely integrated with the income tax" that the *Clifford* case should be controlling. The court therefore considered the income tax situation in holding transfers subject to the gift tax, and refused to apply the same rule in holding a transfer not taxable as a gift. In concluding, however, the court recognized the many puzzling problems presented by the interrelation of the three taxes, in the language quoted at the beginning of this paper.

Let us briefly summarize a few fact situations and see to what extent there is integration between the three taxes, to the extent that we mean by that term the application of consistent rules. Suppose a transfer in trust with power to revoke retained by the settlor, to be exercised only in conjunction with one having a substantial adverse interest. It would be incomplete for estate tax purposes [53] but complete for gift tax purposes,[54] and perhaps incomplete for purposes of taxing the income under the *Clifford* case. Where there is a transfer in trust with the power to modify vested solely in the trustee, it is complete for gift tax purposes,[55] and also may be complete for estate tax purposes,[56] but the income remains taxable to the grantor where the trustee has no substantial adverse interest.[57] Where the grantor reserves the power to modify but only in such a way as not to benefit himself, the transfer is incomplete for gift and inheritance tax purposes,[58] but may be complete so as to relieve the grantor from taxation on the income therefrom.[59] A transfer subject to the possibility of a reverter is incomplete for purposes of both the gift and inheritance taxes [60] but the income is not taxable to the grantors; [61] unless, of course, the control retained by the grantor is so substantial as to bring it within the ruling of *Helvering* v. *Clifford*.[62] A transfer by A to himself and wife as joint tenants is complete so far as one-half of the property is concerned for both gift [63] and income tax purposes but is incomplete to the

[52] 309 U. S. 533.

[53] *I.R.C.* 811(d).

[54] *Com'r* v. *Prouty*, 115 Fed. (2d) 337.

[55] *Herzog* v. *Com'r.*, 116 Fed. (2d) 591.

[56] *I.R.C.* 811(c)(d).

[57] *I.R.C.* 166.

[58] *Sanford* v. *Com'r.*, 308 U. S. 39.

[59] *Buck* v. *Com'r.*, 41 B.T.A. 99; *Knapp* v. *Hoey*, 104 Fed. (2d) 99.

[60] *Helvering* v. *Hallock*, 309 U. S. 106; *McLean*, 41 B.T.A. 1266.

[61] *McLean* v. *Com'r.*, 41 B.T.A. 565; affirmed on appeal of taxpayer on other grounds in 120 Fed. (2d) 942.

[62] 309 U. S. 331.

[63] *Regs. 79*, Art. 2(8).

extent that the entire value of the property, if originally purchased by the grantor, is included in his estate at death.[64]

It is evident that this paper is not intended to be exhaustive, nor to cover all the possible interlocking problems, nor to mention every instance in which courts have applied or refused to apply similar rulings. The purpose has been to present only the broad outlines of the question of interrelation and a few recent instances in which it has been discussed. It will be seen that a great deal remains to be done if consistency is to be achieved. The ordinary taxpayer probably thinks that there are enough inconsistencies in the law already without adding new ones by holding a transfer complete for one purpose and not for another. Legislative action is of course necessary to the extent that consistency cannot be accomplished by administrative or judicial interpretation, but it would seem possible, without abandoning the recognition of a difference between capital and income, to approach a more unified system by the amendment of existing laws, to the advantage of everyone concerned.

Although not strictly within the scope of these remarks, any discussion of coordination between the three taxes should include at least a mention of the relation between the underlying purpose and the economic effect of each one. It has been said that at least one purpose of the death tax is to divert a portion of accumulated fortunes to the public treasury.[65] In other words, it may be said that the policy is to discourage the concentration in a few individuals of large fortunes. As that purpose is accomplished, and fortunes are divided before death, the revenue from surtaxes on income diminishes. Higher gift tax rates in turn tend to *discourage* present distribution of the family fortune. The balance between the three taxes could probably be maintained at any point indicated by current financial needs and policies, through adjustment of rates and exemptions, whether there is completed integration, or an approach to it by the application of consistent tests to the same type of transfer. As long as the three taxes are separate measures, any change in one tax should of course be made only after a careful consideration of its effect on the other two. The extent to which consideration can and should be given by the states to the problems created by the federal tax system or by Congress to the requirements of the states, in considering amendatory legislation, is a subject far beyond the limits of the subject now under discussion.

To summarize, the proposed complete integration of the inheritance and gift taxes seems theoretically beyond criticism and is eminently worthy of legislative experiment. Consistency in determining liability to transfer and income taxes is desirable, and attain-

[64] *I.R.C.* 811(e).

[65] See *Whitney* v. *State Tax Commission*, 309 U. S. 530; Cahn, 29 *Georgetown Law Journal* 677.

able without substantial changes in present statutes. Complete integration of the income with the gift and death taxes is of doubtful validity, and not justified by any injustice or difficulty of administration which cannot be eliminated by less drastic changes.

CHAIRMAN NEUMEIER: The chairman at the session at the University this afternoon advised me that the next speaker, Dr. Harriss, of Columbia University, had not arrived. I wonder if he has since come? Has his paper arrived? We expected his paper to come, so that someone could read it. Hearing no response, I assume the paper has not come, either. I assume, therefore, we should express our courteous regret at the inability of Dr. Harriss to be present this evening.

(The paper prepared by Dr. Harriss thereafter did arrive, and is presented here in full text.—ED.)

THE CASE FOR INTEGRATING THE ESTATE AND GIFT TAXES *

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During the last decade Congress and the Treasury have given close attention to the income tax base. Yet a corresponding concern over the bases of the estate and gift taxes has not been evidenced. The contrast can be explained by indifference, ignorance, and a general uncertainty regarding the appropriate place in the tax structure to be assigned to the transfer taxes. Drastic increases in rates have been followed by larger receipts, yet one must be struck by the relative insignificance of the estate and gift tax revenues; the new rates may yield about as much as the British obtained from a much smaller national wealth in the years preceding the war. Though this country's rates can go higher—considerably higher in the lower brackets—it seems clear that significant increases in revenue await expansion of the base to be taxed.

For many years the government, in effect, retained control over the tax rates but gave the property-owner a very wide measure of control over the base on which his holdings would be taxed, i. e., the portion of the total to be taxed. The disinclination of many to alienate their property, especially when the taxes, income and death, that could be saved were small, frequently but by no means always protected by fisc. The government did make some attempt to check dissipation of the base; certain types of disposition before death were discouraged by the provisions including in the estate gifts in contemplation of, or to take effect at, death. Gradually recognition of

* The views expressed in this paper are solely those of the author and not necessarily those of any organization with which he may be associated.

the inadequacy of these provisions spread. The need for revenue grew. The progressivity of the income tax was threatened. Thereupon the federal and a few state governments buttressed their tax structures with gift taxes. Though this was a major step toward securing an effective death tax (and protecting the income tax), the results may well seem disappointing especially in view of the rate increases. The base is still small.

Many factors contribute to this situation—the generosity of exemptions (the federal estate, gift, and insurance exemptions total $120,000), the multitude of exclusions granted under the gift tax, the low level of property values during the last decade, the provisions regarding powers of appointment and long-term trusts, the nation's age distribution, the removal of the gift tax from the tax base, the deduction of charitable bequests and gifts, the optional valuation privilege—but we shall focus here upon another, namely the division of what is essentially one base into two.

Some definition of the basic objective or goal is a prerequisite for clarifying the issue and reaching a consensus. Yet I have been unable to find that either the Treasury or Congress has formulated a clear statement of what it wants the estate and gift taxes to achieve. This assertion is made without any intent to disparage and solely to help account for the present situation. Leaving aside the questions of the sums to be obtained and the proportion of total revenue to be secured from the estate and gift taxes—for the time being we can legitimately assume that these are primarily questions of rates—it seems possible to formulate a simple, defensible, and generally acceptable statement of what the base of the transfer tax (as a whole) should be.

The decedent's legitimate debts and his contributions to bona fide charitable, educational, and other such institutions should not be in the tax base. An amount determined in some rather vague way by (1) the minimum required to maintain actual dependents and (2) considerations of convenience of administration should be exempted; sums relatively small in total and primarily "non-capital" in character can be advantageously excluded each year. Perhaps property that has very recently paid a transfer tax should be given favored status. The total property in excess of these amounts that an individual transfers constitutes his transfer tax base. In essence this base is an economic unit. It is the amount society permits him to transfer, the legal basis of the transfer taxes. It is also the total of the resources out of which he can make provision for his heirs, the economic reality underlying the taxes. Division of the whole into parts in no way changes the basic fact that there is a total and it is the total that counts.

I take it that we are in general agreement that it is settled public policy that the estate and gift taxes are to be progressive, i.e., that successive increments, representing increasing capacity-to-pay, are

to be taxed at successively higher rates. I also assume general agreement on the principle that individuals in essentially similar circumstances are to be treated alike. Does it not follow then that for purposes of computing progressive transfer tax rates every person's property is to be considered as (1) one unit or (2) two (or more) equal units? One or the other of these rules must be applied universally if the tax is to be progressive and applied uniformly. The rate scale necessary to produce a given revenue will then depend upon which alternative is chosen. But to take the second alternative, division of the whole into equal units, it should be noted, the total must be determined as a unit. Otherwise equal division is impossible.

To date in this country we have followed neither policy consistently. At first some but not all gifts were added to the estate for purposes of taxation. The results were unpredictable—there proved to be little rhyme or reason to account for the difference with which different persons were treated. The short-lived 1924 gift tax provided that all gifts made within a calendar year should be treated as a unit. In 1932, however, Congress went much further. Showing clear recognition of the fact that a progressive tax could be defeated without difficulty if the base could be easily split into many parts, Congress adopted the familiar cumulative provision whereby for purposes of computing the applicable bracket rate current gifts are to be added to all those (in excess of exemptions and exclusions) made after June 6, 1932. Persons making equal amounts of taxable gifts are treated alike so far as the gift tax is concerned regardless of the number of (1) units into which they divide the total and (2) years they take for the distribution.

At death, however, the cumulation stops, to start all over again for the estate tax. The estate, of course, is treated as a unit. That the estate and gift tax are intimately related—in fact that an estate tax to be effective must be supplemented by a strong gift tax—is clearly recognized. Congress seems also to have recognized that cumulation is required to protect a base that is to be taxed at progressive rates but whose size the taxpayer rather than the state would otherwise control in large measure. The remaining step, one of primary importance, is to combine these two principles. This could be done by integrating or combining the estate and gift taxes into a single transfer or "gratuitous transfer" tax.

Drafting such a law would raise many knotty problems of major and minor importance—avoidance of constitutional pitfalls, exemptions and exclusions, the possibility of beginning cumulation at June 6, 1932, the treatment of property previously taxed, the adjustment of credit for state death and gift taxes, the treatment of residuary and contingent interests, etc. To deny the seriousness and complexity of such problems would be foolish, but to assert that they are insoluble seems even more foolish.

The basic objective would be secured by providing (1) that the estate is the final unit in a series of gifts that for tax purposes have been cumulated since a given date or (2) that the estate tax brackets begin where the gift tax brackets ended. The estate of a person who had made no gifts would be taxed as at present. However, if the decedent had made *inter vivos* gifts of, say, \$100,000 above the specific exemption, the lowest bracket of his estate would be, in the present scale, \$100,000 to \$150,000.

Two primary advantages would be gained. The first would be enlarged revenues. The progressivity of the present taxes would become truly effective. Under the present system judicious division of property into two parts, one to be given away before death the other to constitute the estate, makes possible the avoidance of what would be the highest applicable brackets of either the gift or the estate tax. Arithmetic illustrations seem unnecessary. Suffice it to say that generally the effective over-all tax on the total holdings can be reduced to about one-half of the estate tax on the same total. Combination of the estate and gift taxes could not be expected to double the revenue—but only because actual and potential taxpayers fail to take full advantage of the opportunities for tax reduction under the present laws.

However, tax consciousness is certain to grow. The diffusion of accurate information widens every year. It is my feeling that increasingly advantage will be taken of opportunities to avoid tax and that the need for preventive measures grows continually. Though it is obviously hazardous to venture a guess that will be recorded, I should estimate that, given no substantial change in the level of property values, an integrated transfer tax beginning cumulation as of June 6, 1932, and retaining present exemptions would over the next few years bring in from one-third to one-half again as much revenue as the separate gift and estate taxes. It is not improbable that the increase would be even greater. The funds would come from those individuals who, according to the principles generally accepted, would be best able to pay.

The second of the two main advantages would be the increased assurance of uniform treatment of individuals in essentially similar economic circumstances. It might seem that since the present opportunities are matters of public record and equally open to all, the person who fails to take advantage of them has only himself to blame. The pertinency of this observation should not be allowed to conceal its limitations.

To secure the advantages now offered, one must give away well over half, yet by no means all, of his property before death. To do so most advantageously one must know the total amount one will have to distribute. The difficulties are obvious; the difficulties in forecasting the length of the period of accumulation, one's future

income, and the fluctuations of property values can be cited as examples. The existing scheme offers large bounties for accurate guessing. It offers an easier problem for those well beyond middle age than for those with a life expectancy of twenty years or more. The problem is easier for those holding relatively secure investments than for those whose property consists primarily of interests in going concerns. Many persons think it unwise or find it inconvenient to distribute most of their wealth long before death. If they delay, however, death may overtake them before they have been able to make the disposition that will minimize the tax. Income tax considerations in general and capital gains tax problems in particular should be mentioned, as well as the differences in age, outlook, and ability of prospective heirs, the provisions regarding taxation of property previously taxed, and the standards for proving contemplation of death. Today it is much easier for some persons to reduce their transfer tax than for others, and there is absolutely no evidence to show that the factors responsible for the differences should be penalized or granted bounties.

Ostensibly, the amount of a person's wealth is now the variable determining the amount of his tax. Actually many other variables are almost as important. It is clear that they are not distributed equally nor correlated perfectly with the amount of property owned. If it wishes, society can openly decide to discriminate and to grant bounties where it will. There seems to be no logic, however, to support the present scheme of gratuitous, hit-or-miss bestowal. My personal feeling is that so far as possible tax laws should not directly or indirectly force individuals into courses of action they would otherwise avoid unless society expects to benefit from the one action as contrasted with the other.

In one respect, it is true, Congress knowingly chose to discriminate in favor of persons disposing of property before death, though it should be noted that Congress did not go the whole way because after a point retention till death becomes cheaper than *inter vivos* giving. Two reasons were given—distribution should be encouraged and the government can afford to make some sacrifice in order to obtain revenue in advance. The actual concession in favor of gifts, for reasons not pertinent here, far exceeded the twenty-five per cent discount Congress seems to have intended. If the transfer taxes were unified, discount could be granted though it would seem that in most cases the income tax saving is probably an ample tax inducement.

It may be argued that the tax burden would be too great if present estate tax rates were actually applied to the total holdings. Perhaps so, but there are unquestionably estates today to which the rates are applied in full. If effective reduction is desired, then a frank, open policy is to be advocated, not one with disguised favors extended to only a portion of the property-owning group.

Integration would have other advantages. Considerable simplification in the estate, income, and gift tax statutes would be possible. Many borderlines now giving rise to extensive litigation and complicating the drafting of wills and trusts and the whole difficult business of managing property would be abolished. The progressivity of the income tax could be made more secure. The problems arising in the attempts to prove and disprove contemplation of death would disappear. Federal and state relationships might well be reexamined. Administration could be kept within workable limits if a sufficient portion of the specific exemption were deductible only from the estate.

I should like to add a further suggestion. Here it has been assumed that the basic unit for progression is the total wealth an individual passes on to others. Perhaps, however, the coordination might take the form of combining into a unit the amount one generation of a family, father and mother, pass on to the next or the total an individual receives in the form of gifts and bequests during his lifetime. An individual's previous holdings might be taken into account in determining the brackets in which gratuitous receipts are to be taxed. Or gifts and bequests might be taxed as income. These suggestions have been made before. Obstacles to their successful application would certainly arise. Yet in view of the present level of tax rates, the pressure for revenue, the experience gained in administration, and the observed inadequacies in the existing tax structure, it does not seem inappropriate to recommend serious consideration or reconsideration of proposals that have been rejected in the past. The emphasis in this paper has been on what seems to me the most obvious need and the one that could be met most easily.

CHAIRMAN NEUMEIER: It is a little embarrassing to me to have to introduce a man whom I have not personally met. Of course, I know his reputation, and I am very happy to welcome Senator Edmonds.

I know one thing about him—that he is a Philadelphia lawyer; and, of course, all country lawyers are very envious of a Philadelphia lawyer, because they seem to have a national reputation for shrewdness.

Mr. Edmonds is a former president of this Association, Senator in his state legislature, and a man very well versed in the subject of taxation. I am sure it is a great pleasure to welcome up here this evening a former president of this distinguished body, and I take very great pleasure in introducing you, Senator Edmonds, and meeting you myself.

SENATOR EDMONDS: That reputation of the Philadelphia lawyer started with Andrew Hamilton, who was sent for from New York

in the eighteenth century, when there was a very exciting case involving the freedom of the press, in which the royal governor was seeking to persecute and prosecute John Peter Zenger, the publisher of a newspaper in New York, and at that time it was so important to get disinterested counsel that they came over to Philadelphia, and from that time on the phrase has passed into the proverb, "See a Philadelphia lawyer in case of difficulty." We are always glad to tell that story, because it was true then in Hamilton's time, and I hope it is true at the present time.

THE DEPLETION OF BASIC TAX SOURCES IN THE UNITED STATES BY INCREASED TAXATION

FRANKLIN S. EDMONDS

Member, State Senate of Pennsylvania

During the World War, it was frequently observed that when the leaders of the Allies wished to express a fundamental truth in clear, forceful prose, so that the people could understand their message, they invariably quoted from Abraham Lincoln. Our backwoods President was quoted by Asquith, Lloyd-George, Churchill, Balfour, Poincare, and Clemenceau, because he had the gifts of understanding and expression so that the most subtle problems became illuminated by his effective statement. I follow distinguished company, therefore, when I take my text from Lincoln. In the week of the second election in November, 1864, when the serious problems of victory were in the offing, Lincoln wrote, "It has long been a grave question whether any government, not too strong for the liberties of its people, can be strong enough to maintain its existence in great emergencies."

The question which is here suggested is in the heart of every thinking American today. As in the Revolution, the Civil War, and the World War, we are prepared to surrender rights and privileges to the government so that the national result may be obtained, but what afterwards? We must so sacrifice as to insure that what we call the American way of living is preserved intact to our children. Men may differ in their conception of the essentials in the American way, and here I state my own creed, in the hope that its formulation may win your approval.

First: I believe in constitutional government, which means a binding social contract, defining what government may do, and what it may not do, expressing what the citizen should do, both individually and collectively, and what he may not do.

Second: I believe in a federated republic, an "indissoluble union of indestructible states", with national questions settled by the general government, but with the maximum of local questions under

the control of state and local government, with constitutional guarantees as to the freedom of the people in settling home affairs by the home people.

Third: I believe in the provision of opportunity for each citizen to determine the details of his life without let or hindrance from government, except as defined in laws made by his own representatives, so that each may increase in wisdom and stature freely according to his own powers and vigor.

These three beliefs are to me fundamental for the American way of life, and I regard it as the great achievement of Lincoln, that he led this people through the hatreds, and the anguish, and the sacrifices of war, and yet when the war was over, America in these fundamentals, survived. In a period of strain and stress in which we are now living, I want, with all the patriotism and desire of my heart, to see these beliefs survive for my sons.

Now, for the application to taxation. Within the last two weeks, there has gone into effect the heaviest taxing law that America has ever been called upon to face, and already we are told that within a few months there will be a second and more severe measure enacted before the end of the year. With practical unanimity the American people have supported taxation beyond even the heaviest apprehension of the past, and there has been no sign of any weakening of the unanimity with which we have set about the problem of preparedness. Great as the sacrifices we are called upon to endure, they are light as compared with the burdens of the warring nations. Last June, the National Industrial Conference Board published a chart which compared the war appropriations of the United States, Germany, the United Kingdom, and Canada, for the year 1940, with the total national income of each of these states.

National income means the sum of all the incomes of all the people, all wages, salaries, dividends, interest, royalties, any forms of income that the methods of modern business have devised, and that total in the United States was estimated for the current year at eighty billions of dollars, of which, according to the figures of the National Industrial Conference Board, ten billion dollars, or one-eighth, will be devoted to appropriations for arms.

How is it with the other nations? Germany, with an estimated national income for 1940 of forty billion dollars, spent from twenty-four to twenty-nine billion dollars on armament, and the United Kingdom, in the fiscal year 1940, which ends June 30, 1941, had a gross national income of twenty-eight billion dollars, and spent fourteen billion dollars on armament. Canada, in the same period, had an income of three billion seven hundred million dollars and spent nine hundred million dollars on armament.

In other words, the United States, where the united sentiment of the people supports rearming, is spending twelve and one-half per

cent of its national income, or $77 per capita, on armament, whereas Germany is spending from sixty to seventy-two per cent of the national income, with a per capita, on a much lower standard of living, of from $300 to $363 per citizen.

The United Kingdom is spending fifty per cent of its national income on armament, with a per capita of $298, and Canada, our near neighbor, is spending twenty-two per cent of its national income, as compared with our twelve and one-half per cent, on an average of $74, on armament.

It is this comparison that suggests war is a more expensive business than ever before in the history of the nations, and what has happened to Germany, Great Britain, and Canada when they have engaged in war may justify the recent statement of the Honorable Jesse Jones, of the Reconstruction Finance Corporation, that before we have finished with this period, we will have more than doubled our national debt.

Now, the question arises as to the relationship of national income to war expenditures if war is declared, and it seems to me to be clear that all thinking men must contemplate the approach of war when we read in the newspapers of the destruction of American boats in the Atlantic Ocean, and it seems to me those of us that can remember 1916 and 1917, feel our blood running a little more strongly.

In 1918—that was the year of the World War—this country had a national income of $38,000,000,000 and expended for war $18,000,000,000, which you see was almost half the total income. Great Britain had a national income of $10,700,000,000, expended for war $13,896,000,000 — $3,000,000,000 more than the national income. France had an income of $7,300,000,000 and expended for war $10,671,000,000.

Both France and Great Britain, by expending more than the national income — and, of course, a portion of the national income had to be used by the recipients for living purposes—that increased their debt and the question arises as to the policy of nations in the past, as to the amount of war expenditures that can be raised from current taxation and the amount which must be borrowed. In the World War, the United States raised 25.9 per cent of its war cost by taxation; Great Britain 24.7 per cent; France 15.4 per cent; Italy 14.9 per cent; Germany 11 per cent, and Japan 62.2 per cent.

That has been the rule of the United States in all of the great wars in which this country has engaged: 25 per cent from taxation and 75 per cent from borrowings.

Assuming that we continue this ratio of one dollar in taxes for every three dollars in borrowings, and assuming also that the United States is to become "the arsenal for democracy", it is evident that far greater and greater taxes will be asked by the federal govern-

ment, and the sacrifices of the past are puny compared with our prospective sacrifices of the future.

The question then arises, how will this affect the fiscal program of state and local governments. Mr. Lepawsky showed yesterday the income of city and state was increasing, due to expanded business, and this condition is likely to continue for at least a year. Of course, if sales of cigarettes to the army are to be untaxed, the cigarette-taxing states will find a loss from this source; if federal administrators are to ration gasoline, there may be a serious curtailment of the highway program of the states which finance the cost from gasoline taxes; if corporation income and excise profits taxes are to be increased to 60 or 70 per cent of net profits, the income of those states which finance by corporation net income taxes will suffer. But in the main, what is lost in one form of taxation will be made up in another, and it looks clearly to me as if the states and also local governments will be able to pay their debts for a year or two.

But when the emergency has passed, then Lincoln's question has keen applicability — "has the government which has been strong enough to maintain its existence become too strong for the liberties of its people?" Will there be any sacrifice of the fundamentals of the American way in which we believe? I am not protesting against high taxes for public defense. As an American, I glory in such taxes, but I am asking what will be the effect of the continuance of these methods of taxation after the emergency has passed.

For some years, we have seen the doctrine of "ability to pay" stretched in its application to income and estate taxes until in 1941 it has reached its climax in this country. What has been the effect on the financing of the states? The Federation of the Tax Administrators gave me the returns to the states and the nation from all forms of death duties as follows:[1]

1927.......	State	$123,948,000	Federal	$100,340,000
1928.......	"	127,540,000	"	60,087,000
1929.......	"	148,590,000	"	61,897,000
1930.......	"	180,796,000	"	64,770,000
1931.......	"	182,652,000	"	48,078,000
1932.......	"	149,416,000	"	47,422,000
1937.......	"	113,888,000	"	305,548,000
1938.......	"	141,918,000	"	416,874,000
1939.......	"	129,233,000	"	360,700,000
1940.......	"	117,907,000	"	360,100,000

[1] For details by states, see Appendix A.

I sent these figures to the tax commissioners of twenty-four states, where death duties have been a major part of the state's revenue, and submitted three questions as follows:

1. During the years of this survey has there been any change in the law relating to the rates or nature of death taxes in your state? If so, will you please advise me of the same?

2. In your judgment, is the recent decline in state death tax collections due to a decline in the appraisement caused by a decline in the values of securities?

3. In your judgment, is there any danger that the heavy estate taxes of the federal government added to those of the states may result in time in permanently decreasing the size of estates so as to result in a decline in the importance of death taxes as a stable portion of the state budget?

To my third question, which is vital to this paper, I had affirmative answers from the following: Pennsylvania, Colorado, Minnesota, West Virginia, New York, Connecticut, California, Rhode Island, Iowa, South Carolina, Ohio, New Jersey, Massachusetts, North Carolina, — total 14, and negative replies from three states, namely, Indiana, Kentucky, and Illinois.

I then found that in Pennsylvania the only state tax which had not collected its formal estimates in 1939-1941 was our inheritance tax, which fell off $5,000,000 on the estimate made at the commencement of the biennium. Through the courtesy of the Pennsylvania State Department of Revenue, I also received data which showed that the total of estates in excess of $500,000 had declined from $356,000,000 in 1931 to $35,540,000 in 1940.

Some rejoice that the era of great fortunes has passed, but certainly no state tax administrator can share in that unholy joy. Now, I hold no brief for the millionaire, but I feel that he has allowed a fictitious case to be made against him which may pervert the industrial policy of the nation. I have no defense for the unworthy sons and daughters of wealthy industrialists who have used the hard-erned savings of their ancestors for pleasure and debauch, but I direct the attention of our legislators to the fact that in order to check the excesses of a Harry Thaw, they may establish here an industrial system which would make it impossible for Henry Ford, who started with but $29,000 cash capital, to make it grow into a business employing its hundreds of thousands; or the benefactions of Rockefeller, Jr., who has stimulated every civilizing influence in the nation, and at the same time raised a family of patriotic and God-fearing children, or the enterprise of the duPonts, who in their 1940 report were able to announce as follows:

> "Twenty-five years ago practically all the dyes used in this country were imported from Europe. In 1917, your company

began the manufacture of dyestuffs, and in the first eighteen years of this venture invested more than $43,000,000 in the business before sufficient profits were earned to offset the accumulated operating losses. The business is now established on a profitable basis. Domestic needs for dyestuffs are now adequately met by manufacturers in the United States."

I have obtained the probate records of forty-two estates,[2] representing about 24 states, which had a gross value of $88,349,480. After payment of debts, administrative expenses and taxes, the net total of our estates was $46,568,325. The total of state death duties was $8,897,055, and of federal taxes $25,716,338. Here is a total of $35,000,000 paid to government from capital for the current expenses of government, and it means that there was $35,000,000 of wealth on which these decedents paid taxes in 1939, that in 1942 is no longer on the tax roll, and in many cases this means that the neighbors of these decedents will now pay higher property taxes.

Now, what is the effect of such taxes on American life. Ours is a dynamic, moving, changing economy. Every successful man knows that he must render a better service, or make a better product, or some other will take his place. Our leaders are kept on the continual alert, or their venture capital is lost. Will they be willing to run risks with the little that they can save out of 80 percent income taxes, if the result of the venture goes in large measure to government. Note the wise words of Carl A. Snyder in his *Capitalism the Creator*.

> "The last forty years or more have seen a huge increase of governmental expenditure in most countries, and therewith a search for new methods of heavier taxation. Almost universally this has taken the form of progressive income taxes, Great Britain being a conspicuous leader. But Great Britain has not been conspicuous in this period in gain of national wealth. Very little, if any, increase in its real income per capita; and since the income of the workers is a nearly fixed share of the total, little increase in the average of real wages. In this same period the United States, at least until 1930, were going forward at very near the same steady rate, per capita, as in preceding generations; and with this a steady advance in real wages and enjoyments.
>
> "Why the difference between the United States and Great Britain? The reason, I think, is clear. In the United States, until 1930, there was a nearly constant addition to the capital invested in industry, for at least a hundred and forty years. This has permitted the prompt introduction of new machinery, new inventions, discoveries, processes, which have steadily aug-

[2] See Appendix B.

mented the volume of output. While the rate of expansion in the United States continued, in England it began to decline, particularly in the last thirty years. Why the difference? The usual answer is that nations, having grown rich and powerful are much like individuals; they lose their vigor and their enterprise. Perhaps some element of truth. But I believe there are more positive factors, and one of them is the drive towards heavy taxation of income.

"No one knows just why enterprisers are driven to work so hard, to accumulate vast fortunes, from which they seem to derive so little enjoyment in their old age. Probably it is the sheer zest in achievement, and not merely love of gain. But profits are an essential part of achievement. Without profits they cannot expand their enterprises, adopt new inventions, which are the source of their success. Evident that one way to dampen this ardor of achievement and so to check this gain in well-being, is to confiscate the higher profits. When there is no favorable prospect, many of the most competent see no motive for staying in business at all. Which is what has happened recently in the United States." [3]

This suggests my conclusion. It is that if the present methods of taxation are continued after the emergency is past, they will chill the ardor for achievement, destroy the free capital of the nation, change our industrial economy to a static basis, and eventually destroy the fiscal integrity of the states. It is because of this belief that I have argued so strongly for coordination of the federal, state and local taxing systems. If one branch of our government may destroy the basis upon which the other branches rely, the dominant branch may destroy the integrity of the federal system, and reduce us to the level of a totalitarian state. I do not want to see this change take place. It would ruin the American way—and therefore I present it to this loyal group of well-informed, patriotic Americans, and ask them to pledge their best efforts, with me, to work out an American answer to Lincoln's question.

[3] See also "The War of Industries" by Frank C. Hanighen in *Harpers Magazine* for May, 1940, in which the author states as follows:

"The International Labor Office in Geneva has published some figures about productivity per worker in the various large industrial countries, which throw much light on this British backwardness in the industrial race. Between 1860 and 1910 British productivity per worker increased 34 per cent. German productivity between 1822 and 1907 increased 69.8 per cent. The productivity of the United States between 1859 and 1899 increased 101 per cent. In post-war years, British productivity rose only about 1.8 per cent annually, while the German rose about 3.5 per cent and the American 4.8 per cent.

"The best brains in England have long been aware of these facts."

APPENDIX A

DEATH TAX COLLECTIONS
(in thousands of dollars)

State	*1927*	*1928*	*1929*	*1930*	*1931*	*1932*	*1937*	*1938*	*1939*	*1940*
Ala.	—	—	—	—	—	—	75	218	198	262
Ariz. ...	122	40	80	284	80	80	52	51	406	167
Ark. ...	222	234	312	283	263	95	185	128	174	235
Calif. ...	8,461	10,968	13,180	11,647	13,736	10,094	5,838	10,480	8,372	10,530
Colo. ...	675	869	920	900	995	777	993	1,159	944	1,207
Conn. ...	2,597	2,978	3,579	3,607	4,816	4,097	3,285	3,431	3,793	3,590
Del.	191	622	2,576	1,853	1,771	2,067	321	506	258	472
Fla.	—	—	—	—	—	170	1,156	449	1,535	923
Ga.	194	603	697	359	278	278	336	133	236	472
Idaho ...	11	33	31	36	39	41	66	49	108	80
Ill.	5,530	9,054	9,821	16,092	10,708	6,534	5,096	7,350	5,636	4,384
Ind.	1,109	1,172	1,213	1,451	1,943	1,944	1,239	804	1,071	1,333
Iowa	1,110	1,215	1,105	1,234	941	808	960	1,138	1,516	1,021
Kan.	516	716	596	684	547	463	400	286	500	375
Ky.	666	732	1,011	1,024	1,067	677	904	1,077	1,867	1,200
La.	628	690	698	689	528	528	532	665	630	638
Me.	799	1,692	922	1,010	2,653	921	979	663	578	661
Md......	674	854	882	1,416	2,162	2,162	1,589	1,982	2,005	1,721
Mass. ...	10,750	10,335	12,082	14,337	11,689	11,688	7,689	7,696	11,082	9,373
Mich. ...	1,949	2,322	3,325	5,420	5,968	5,580	4,175	8,479	4,964	2,736
Minn. ...	1,182	1,278	1,554	1,529	2,209	1,828	792	1,235	1,980	1,355
Miss. ...	128	160	65	42	30	30	31	63	100	49
Mo.	1,937	3,040	2,730	3,841	2,753	2,753	1,403	2,168	1,639	1,962
Mont. ...	493	662	154	213	235	417	470	704	233	187
Neb.	—	—	—	20	22	180	44	54	63	155
Nev.	1	—	—	—	—	—		—	—	—
N. H. ..	316	416	385	480	380	380	709	868	746	1,103
N. J. ...	11,295	11,206	7,536	15,766	10,227	11,108	8,412	9,032	6,916	5,621
N. M. ..	19	23	37	66	34	24	188	42	51	44
N. Y. ..	24,564	35,651	47,221	50,487	52,691	45,802	33,650	34,041	35,450	28,956
N. C. ..	799	698	922	1,196	963	428	3,963	2,152	881	1,009
N. D. ..	63	30	36	31	19	29	20	28	32	41
Ohio	2,484	2,524	2,969	2,999	3,789	7,699	2,208	2,409	5,446	4,561
Okla. ...	160	332	414	187	227	227	392	367	565	1,635
Ore.	550	610	544	1,230	823	823	550	1,113	498	652
Pa.	17,300	17,161	17,526	26,844	38,640	18,933	16,828	28,502	21,077	19,575
R. I. ...	603	613	4,661	6,155	992	1,120	803	1,830	1,323	1,206
S. C. ...	350	140	355	260	132	132	138	141	191	141
S. D. ...	163	224	193	193	164	241	83	73	41	52
Tenn. ...	539	444	534	341	885	771	990	860	1,438	854
Tex.	1,562	1,029	1,247	782	910	910	729	1,114	604	713
Utah	248	348	269	381	296	166	190	311	336	164
Vt.	434	362	502	507	259	432	235	407	317	250
Va.	667	669	924	1,096	1,090	518	705	553	830	722
Wash....	580	656	680	543	967	911	1,771	1,443	2,018	1,445
W. Va. ..	1,027	616	1,278	751	1,074	418	509	553	700	521
Wis.	2,256	3,401	2,722	2,462	2,599	4,066	4,154	4,977	3,635	3,508
Wyo.....	24	118	102	68	66	66	51	134	43	46
Federal..	100,340	60,087	61,897	64,770	48,078	47,422	305,548	416,874	360,700	360,100

Sources: Financial Statistics of States, '37, '38.
State Tax Collections, 1940; State Tax Collections: Fiscal Year, 1938-39.
U. S. Treasury Report '40, for 1939 and 1940 U. S. Totals.

APPENDIX B

Illustrations of Shrinkage in Estates of $500,000

State	Gross Estate	Total Costs	Net Estate	Inheritance Tax	Federal Estate Tax
Minn.	$534,879	$129,566	$405,313	$12,874	$83,771
Pa.	419,667	93,203	326,464	8,157	49,057
Col.	529,484	204,477	325,007	27,123	89,011
Ore.	686,195	168,260	517,935	44,711	95,877
Ill.	470,351	62,561	407,790	6,679	43,147
Ohio	628,689	164,256	464,433	40,045	87,963
Conn.	651,869	152,780	499,089	39,095	95,870
Md.	374,571	88,198	286,373	9,040	44,084
Ill.	684,932	138,007	546,925	31,442	97,044
Minn.	419,737	87,443	332,294	9,851	42,826
Wash.	492,679	115,630	377,049	25,815	63,799
Mo.	538,854	131,740	407,114	22,294	70,352
Mich.	574,034	154,619	419,415	33,734	75,113
Ind.	445,864	96,650	349,214	2,393	52,488
N. Y.	643,267	174,235	469,032	14,222	80,424
Okla.	659,557	148,980	510,577	31,600	96,828
	$8,754,627	$2,110,605	$6,644,024	$359,165	$1,167,654

Illustrations of Shrinkage in Estates of $1,000,000

State	Gross Estate	Total Costs	Net Estate	Inheritance Tax	Federal Estate Tax
N. Y.	$1,180,007	$291,876	$888,131	$10,882	$203,693
Mo.	824,091	297,173	526,918	80,445	114,925
Wash.	1,238,143	375,557	862,586	104,696	227,182
N. Y.	1,182,161	308,064	874,097	39,727	168,530
Pa.	1,578,088	446,167	1,131,921	64,562	306,048
Neb.	1,303,895	481,641	822,254	4,836	207,890
Ill.	995,463	279,307	716,156	30,317	191,013
N. Y.	991,727	251,398	740,329	38,372	164,511
Pa.	1,039,126	271,623	767,503	30,709	176,678
Ohio	785,235	187,061	598,174	15,894	116,729
Va.	922,464	261,025	661,439	59,362	146,482
Wis.	1,473,755	474,544	999,211	134,634	270,731
N. Y.	1,168,669	472,644	696,025	25,415	134,854
Mich.	961,439	252,652	708,787	37,117	153,666
N. J.	1,202,759	436,350	766,409	49,671	167,012
Va.	1,566,611	441,879	1,124,632	47,624	298,942
	$18,413,533	$5,528,961	$12,884,572	$774,263	$3,048,886

Illustrations for Shrinkage in Estate of $2,500,000

State	Gross Estate	Total Costs	Net Estate	Inheritance Tax	Federal Estate Tax
Calif.	$2,742,060	$1,086,896	$1,655,164	$124,292	$539,195
N. Y.	2,243,843	844,933	1,398,910	119,577	425,705
N. Y.	2,074,878	477,556	1,597,322	74,194	282,662
N. Y.	1,927,111	644,581	1,282,530	93,690	346,669
N. Y.	2,706,544	1,005,327	1,701,217	171,881	665,793
Pa.	2,643,916	981,604	1,662,312	256,500	573,925
Ill.	1,812,074	631,322	1,180,752	116,178	335,050
Me.	2,279,428	707,089	1,572,339	50,643	473,090
	$18,429,854	$6,379,308	$12,050,546	$1,006,955	$3,642,089

APPENDIX B—*Continued*

ILLUSTRATIONS OF SHRINKAGE IN ESTATES OF $10,000,000

State	Gross Estate	Total Costs	Net Estate	Inheritance Tax	Federal Estate Tax
Pa.	$10,434,948	$6,069,998	$4,364,950	$1,523,578	$3,800,223
N. Y.	32,316,518	21,692,285	10,624,233	5,233,124	14,057,486
	$42,751,466	$27,762,283	$14,989,183	$6,756,702	$17,857,709
	$88,349,480	$41,781,157	$46,568,325	$8,897,085	$25,716,338

CHAIRMAN NEUMEIER: I am certain that the Senator has maintained with distinction the reputation of the Philadelphia lawyer. Yea, I think he has enhanced that reputation by his address here this evening.

That concludes the formal reading of our papers, unless the other speaker has arrived. It is only nine o'clock, and we have ample time for a round-table discussion. The subjects tonight have not been as controversial as most tax matters. Does anyone want to lead the general discussion and ask questions, and try to stump the experts? Or is everybody satisfied with death taxes as they are? Going, going, gone!

PRESIDENT MAXWELL: One of the important responsibilities of this conference is to express its views through resolutions adopted. Each state delegation here is requested to select its member of the resolutions committee. Mr. Query, the chairman of the committee, tells me that there are only three states that have handed in the member of that committee so far. I wish you would please give this attention and pass in to the registration desk the member of the resolutions committee for your state. Each state is entitled to one member.

(The meeting thereupon adjourned, at 9:05 P. M.)

THIRTEENTH SESSION

TUESDAY, OCTOBER 14, 7:30 P. M.

Spanish Room, Lowry Hotel

ROUND TABLE CONFERENCE

EDWIN E. WITTE, presiding.

(Participants on this program included Mr. John T. McCullen, Regional Representative of the Social Security Board, Mr. Emerson P. Schmidt of the University of Minnesota, Mr. Victor Christgau of the Minnesota Division of Employment and Security, and Mr. Charles Hoffman of the Minnesota Employers Association. Presented herewith are the papers delivered by Mr. Schmidt and Mr. Hoffman, together with the concluding remarks of the Chairman. —Editor.)

INCENTIVE TAXATION WITH SPECIAL REFERENCE TO UNEMPLOYMENT

EMERSON P. SCHMIDT
University of Minnesota

The demand for economic security falls way short of the supply. The American people will never again tolerate mass unemployment. If the government can create full employment for war purposes, why can the government not dig up the funds to maintain a full standard of living for all the people in peace time? The problem at this juncture is not pump priming for recovery, but rather it is how can we maintain full employment after the defense effort is over.

The drift toward strong central government, totalitarianism, and dictatorship is a response which people are making in order to attain the desired security. Students of the collapse of European civilization widely agree that unemployment is at the bottom of the European debacle. Freedom might still prevail and war might have been avoided if a substantial proportion of the people had not been receptive to "some new social order." Whether America can provide sufficient economic security to prevent people from resorting to political channels is problematical.

In spite of the fact that the standard of living of the workingmen in America is the highest in the world and has been rising at an average rate of approximately 1.5 percent per year, there is some-

thing fundamentally wrong in the relations between employers and workers. American business—capital, labor and management—in its cooperative effort has yielded an enormous per capita output, but capital and management are definitely on the spot. Apparently, with all that has been furnished the American laboring man, something has been lacking. That something can be designated more accurately by the phrase "adequate security" than by any other phrase.

"Management expects a little too much when it asks that labor be loyal and faithful, when it is considered that labor is the first thing separated from the payroll, when business clouds begin to appear," said Henry L. Nunn, president of the Nunn-Brush Shoe Company, in giving one reason for the adoption of his now-famous annual-wage plan. He had noted that office personnel generally is loyal and faithful to an organization while the same could not be said of plant employees. He knew that there was a good and obvious reason for this.

Countless persons through speech and writing are urging us to save democracy, few of these have a program other than mere words, of which the supply exceeds the demand. If words and more words were enough this would be a very temperate, law-abiding, and highly moral world. Words and propaganda fall largely on deaf ears unless they carry some compulsion from without or sanction from within. Thus if we would save democracy, we must correct the basic economic factors which are threatening its survival. Talk alone will not do it.

There is a significant parallel in the developments in Europe and America. Workmen's compensation, old-age pensions, unemployment insurance, the youth movement, militant class struggle, strong reliance on government for the people's welfare—all of these came to one or more of the European countries a generation before they became of substantial significance in the United States. If this parallel continues, we may expect the same kind of class struggle and ultimate totalitarianism that has engulfed Europe.

It appears that when a large portion of the people come to rely on government for their income and economic security, that government must be strong to carry out that responsibility. It must be free to command, to act, to brush aside all opposition—otherwise it cannot produce results. Possibly this means dictatorship.

The scope and area of personal liberty seem to be closely correlated with freedom of enterprise. The failure of voluntary solutions for our social and economic problems will result in greater government intervention. That this means reduced freedom and liberty is suggested by the Hatch law restricting the freedom of public employees, by Mayor F. La Guardia's pronouncement when the City of New York took over the subways that the transport workers' claimed right to strike and the closed shop will not be tolerated, and President Roosevelt's charge to W.P.A. strikers, "You cannot strike

against the government." All these are symptoms of the true inwardness of the interventionist state.

Clearly if our historic liberties are to be preserved, further government intervention is not the answer.

Mere verbal endorsements of democracy are not enough. Rather, the people must, through their own day-to-day experiences, be able to come to the conclusion that their lot is not too bad and that some new social order is not necessary. That is, they must come to this conclusion voluntarily and as a result of their own personal experiences and not through reading and listening to lectures. The written and spoken word can do something to save democracy but it is woefully incapable of doing the job at hand.

That the present is not just another World War with power fighting power, is vaguely realized by a large number of people. That the foregoing is not merely the idle speculation of someone who reads too many books is suggested by the following quotation taken from a speech by Charles E. Wilson, President of General Electric Company Mr. Wilson said,

> "Instead there must be a complete, realistic comprehension of the fact that the world—our nation included—is passing through what history may later record as the second stage of a revolutionary movement of the masses—a movement born during World War I and likely to last, with intermittent armistices of one kind or another, for two or three decades more. We must fully realize that this is a movement based upon a sense of frustration—an emotional manifestation frequently approaching unreasoning, sacrificial hysteria—and we must see that, as such, it can be turned to a course of reason only by reasonable and sacrificial actions of a character which appeal to to the emotions and the aspirations of the masses more than do the actions and the appeals to which they are now responding.
>
> "Today, the practical controlling fact is that hundreds of millions of people throughout the world have been persuaded, to the point of evangelistic conviction, that the capitalistic system is the cause of the economic insecurity of the common man and that, as the root of his economic ills, this system must be drastically modified, or failing that, destroyed." [1]

The historic function of private enterprise has been the bringing together of capital and labor into productive enterprise for the development of old and new products. Unless private enterprise solves the unemployment problem, the government will take over.

If the foregoing is a correct analysis of the drift of the times, it is incumbent upon all persons in responsible positions to explore all devices which may encourage both full and stabilized employment.

[1] *Total Security—A Challenge* by Charles E. Wilson, President of General Electric Company, 570 Lexington Avenue, New York, p. 4.

Incentive taxation is one device, the possibilities of which are just being recognized, although only zealots would say that it alone will do the job that is to be done.

Depressions are characterized primarily by the shrinkage in the mand for durable goods. Prolonged depressions may generate social and political unrest so that depressional unemployment is transformed into secular stagnation—or continuous depression.

Unless we lose all hope the problem seems to be to prevent depression. To prevent depressions a prime requisite is to prevent excessive booms during which durable goods are produced at a rate which cannot be maintained. Open market operations and rediscount policy are widely believed to be adequate, if used with wisdom and courage, to prevent excessive booms. Thus if excessive booms can be avoided prolonged periods of deep stagnation are less likely to occur.

Bank policy, it is generally agreed, is likely to be inadequate to restore business once depression has set in. This is true partly because bank policy operates upon short-term capital supply which is not of crucial importance in the production of capital goods.

Can the tax structure be redesigned to fill the gap? Employing the tax structure to obtain full use of resources is not new. Half a century ago Henry George recognized that the tax on improvements upon real estate discouraged the absorption of land into productive use. He developed the idea of the single tax as a spur to land utilization; economists generally have agreed that his idea was sound. The Swedish economists especially have argued that our tax policies are not geared to the modern world. There is no more reason why a government's budget should be balanced every year than that it should be balanced every month, week, or day. The year, they say, is an arbitrary accounting period. Rather the period of time over which a budget should be balanced should be flexible and should be roughly equal to the length of a full business cycle. During prosperity governments should build up a reserve, or more realistically, they should pay off their debts and put their financial houses in order so that when the next depression comes instead of increasing taxes to meet relief and debt costs, taxes should actually be remitted in order to improve the cost-price relationship of business enterprises. Any deficit occurring should be met by borrowing. This budgetary policy should be complemented with a system of planned public works. Such a program might be a part of a system of incentive taxation. During the depression of the 1930's nearly all our governmental units—local, state and federal pursued an opposite policy, loading additional taxes on bogged-down business.

However, in order to maintain or increase the rate of spending, the government might go a step further and provide specific sub-

sidies (taxation in reverse) to employers who increase the number of their employees, their man hours, or payrolls. Subsidies might be granted for expansion of inventory or plant. Whether the subsidy is given in the form of a tax reduction or remission or in the form of a tax-credit certificate, it constitutes a stimulus to the expenditure on wages, equipment or plant.

This proposal has the advantage that it stimulates all industries to expand simultaneously instead of concentrating the initial stimulus upon only a few industries as does a public works program. Furthermore, such a program is prompt and flexible. It does not call for setting up hundreds of new agencies—rather it employs the existing agencies—the United States Treasury and private enterprise. Public works tend to get under way slowly and awkwardly. This plan could be set in motion at any time and to any desired degree; the incentive features could be withdrawn as private enterprise began to take hold. The government, under this system, does not compete with private enterprise and thus this threat to long range private commitments is barred. If successful, the plan would put people to work in private industry where expansion is likely to be the most economic—instead of giving the people parks, bridges, auditoria and other structures which can be dispensed with. Industries would not be stimulated disproportionately so that workers would not have to shift from their habitual jobs to occupations in which they have little skill.

A tax on idle money is another form of incentive taxation widely proposed. Depressions are accompanied not primarily by a decrease in money—either legal tender or credit—but rather by a decrease in turnover. The decrease in turnover or hoarding is both a result and a cause of business decline. By instituting a tax which would maintain the rate of turnover, depressions could be mitigated. Money turnover taxes could be levied against both persons and corporations.

Most proposals would collect the tax through banks or would use a special type of legal tender currency. Proposals for a nonhoardable currency include stamped scrip, to which a tax stamp would have to be affixed by the holder on a certain date, and special dated dollar bills or "calendar currency," which would depreciate a certain number of cents each month or any other period of time selected. The tax, of course, could also be varied in amount from time to time as it seemed desirable to speed up spending. The need for a hoarding tax on checking accounts as well as on all currency is recognized, because about nine-tenths of the country's money supply consists of such bank accounts.

Idle money in an exchange economy means idle men and idle machines. Hoarding, or a decreased rate of use of money, reduces incomes and employment. Without hoardable money price maladjustments and pessimism could not result in a failure to spend.

During a depression, unfortunately, hoardable money is a good speculation because it increases in value in a price decline and it involves little, if any, carrying costs. Unlike real estate, it is generally not taxed; unlike commodities, it presents no storage problem. Furthermore, money is a liquid asset, representing generalized purchasing power. Consequently, it is not subject to losses in the same way that investments in particular enterprises or commodities are, and it can be used at any time. During depressions, interest rates, the reward for not hoarding, are likely to be low. What a hoarding tax does is to penalize the non-use of money, making idle holdings have a negative rate of interest.

Government spending programs are supposed to stimulate private capitalists to follow suit. But hoardable money permits its holders to refuse to be tempted. Liquid capital can continue to lie idle, and those who hold money can decline to spend it until confidence is restored. A hoarding tax, by forcing money to circulate, helps to maintain demand. It is for this reason that J. M. Keynes, the English economist, believes the idea behind stamped money to be "sound."[2]

The most comprehensive plan for taxing hoarding is suggested by Arthur Dahlberg.[3] He would have the currency consist of a new type of depreciating dollar bills and would levy a monthly tax on average balances in checking accounts above a $300 minimum. Numerous devices and restrictions are also suggested to prevent evading the tax without really spending the money. The controls necessary to plug up loopholes would certainly have to be rather complex and complicated. In order to forestall a shift into foreign money, the country would apparently have to be off the gold standard and perhaps use some form of exchange control. A severe hoarding tax would also stimulate a wholesale shift of funds from checking accounts to savings accounts and other liquid assets, which would sharply contract the volume of checkbook money. Such a liquidation of checking accounts would tend to nullify the plan, because total spending is a product of the money supply times its rate of turnover or velocity of circulation. In order to prevent a reduction in the quantity of money, Dahlberg suggests the adoption of the 100-percent-reserve plan for money, which has been endorsed by a number of economists, along with the hoarding tax. Such a plan for full cash reserves would permit a stabilization of the quantity of money and would prevent individuals or banks from reducing the money supply.

It may be argued that the foregoing suggestions would involve complicated administrative machinery, or that we cannot be certain

[2] Keynes, J. M.: *General Theory of Employment, Interest and Money,* p. 357.

[3] Dahlberg, Arthur: *When Capital Goes on Strike; How to Speed Up Spending* (1938).

that they would work. They are submitted, however, for consideration and not in the form of a recommendation. It might be said in mitigation that the policies of inaction—until the horse is stolen—and the program of pump-priming and public works also involve difficulties or enormous administrative machinery and few people are convinced that the latter has done the job from 1933 to 1939 for which it was designed.

EXPERIENCE RATING IN UNEMPLOYMENT COMPENSATION LAWS

Another device whose employment regularization power is now being explored in America is *experience rating* in unemployment compensation laws. In most of the states employers, instead of paying a uniform payroll tax to finance unemployment compensation benefits, may qualify for reduced taxes if they regularize their employment—hence *experience* rating. The tax rates in some states run from a minimum of zero for stabilized companies to a maximum of 4 percent on the payroll with considerable variations of minima and maxima in the several states. Stable employment earns the low rate; unstable employment is penalized with the higher rates. The employer for the first time is given an immediate cash incentive to keep men on the payroll. Continuity of employment will earn premiums to a degree never before attained. Hundreds of thousands of employers responding simultaneously to this incentive may mean new security for millions of workers.

When unemployment insurance laws were first proposed in Wisconsin in the early 20's, organized labor in that state insisted that instead of following the traditional European system of uniform payroll taxes on employers and employees, the tax should be levied exclusively on employers but this tax should be a variable one, penalizing the unstable industries and rewarding those that stabilize. Wisconsin pioneered in adopting this type of law as early as 1932, and the principle was incorporated in the national Social Security Act of 1935.

The argument for experience rating is two-fold: first, each commodity produced should bear its full costs; and second, the employer should be given an incentive to regularize his operations.

PROPER COST ALLOCATION

If the public demands products or services which lead to irregular employment, either because the demand is intermittent or because the supply of raw materials is intermittent and irregular, then the public should be made to bear the full cost of providing the necessary resources to produce these commodities or services. It would be generally agreed that a successful newspaper should not be rerequired to pay the real estate taxes of an unsuccessful one, or that a public utility should not be required to help finance the payroll of a decrepit cast-iron works, so that the community could have

cast iron produced from that works. Similarly, industries which are most stable and therefore provide the most *employment* should not be forced, through a payroll tax, to subsidize the unstable industries which provide the most *unemployment*.

Under workmen's compensation for financing accidents, payroll premium rates vary from 5c or 6c per $100 of payroll for clerical work up to $30 or $40 for highly hazardous occupations. While the employers in hazardous occupations might like to force the non-hazardous to pay a part of the financial burden, the system as it now operates is generally accepted by both organized labor and employers. The analogy between unemployment and workmen's compensation is not a perfect one, but this social cost allocation argument has validity.

STIMULATING EMPLOYMENT REGULARIZATION

Everyone would agree that unemployment is to some extent preventable and to that extent experience rating in unemployment compensation tax laws may encourage its prevention.

In Europe, employees contribute to finance unemployment compensation. In the United States the tax generally is levied upon the employer alone. To the extent that unemployment is a problem of business management it must be made expensive. If unemployment is a social problem, it should be financed by taxes on employees or by general levies because if levied on the employer as measured by payrolls it gives incentive to economize in the use of labor; thus it might create rather than prevent unemployment. The tax on the employer can be justified only if some other social gain can be achieved. This social gain is unemployment prevention.

If the payroll tax for financing unemployment remains at 3 percent, as in the non-experience rating states, this constitutes a greater deterrent to the absorption of additional labor into productive enterprise than is the case under experience rating; this is true because once the employer has learned the technique of providing steady employment he can take on additional workers without incurring any additional payroll taxes above the minimum rate of .5 percent (in Minnesota for example) or additional tax liability is avoided as soon as the necessary reserve ratio is built up after increasing the payroll (Wisconsin). Thus if we must have payroll taxes levied upon the employer to finance unemployment, experience rating has the advantage over a pooled account without experience rating.

Critics of experience rating argued that the small potential payroll tax saving of 2 percent to 4 percent on the payroll will not constitute a sufficient saving to induce employers to regularize further, since regularized operation, even without experience rating, is the most efficient form of operation; using plant and labor fully throughout the year reduces unit overhead costs to a minimum, and maintains skill and avoids unnecessary recruiting and training costs.

Unquestionably for most businesses, these indirect savings from continuous operation exceed 2 to 4 percent of the payroll. In Minnesota the *average* tax rate on all employers in the first year of experience rating was 2 percent for all eligible employers. In 1940 the average rate in Wisconsin was 1.6 percent. Thus, there can be no question about the tax savings under experience rating.

Nevertheless, single-product industries and many multi-product industries with seasonal peaks do operate at varying levels throughout the year. Tradition and inertia keep them that way. In former periods with smaller cities, less urbanization and industrialization, intermittent employment was of less social consequence. Yet many industrialists have continued to hire and lay off employees without much regard to the changed conditions. Furthermore, it must be recognized that in many cases it appears less costly to take people off the payroll than to keep on producing. Experience rating tries to reverse this process.

The payroll tax savings under experience rating are the bait which the state legislatures are holding out to these employers.

The provision of continuous employment in many cases costs money. For example, when seasonal sales decline a building-for-stock program will require additional warehouse space, extra handling, insurance, tax, and possibly obsolescence costs. The potential payroll tax saving which year-round work may earn constitutes an offset to this outlay, so that under experience rating, instead of stabilization costing money, it may pay the employer to engage in some operations which he otherwise would regard as unduly hazardous or costly.

Similarly, for an employer to go out of his way to diversify his market or diversify his line with a view to providing production stability may for the first time become worth-while to him, since he knows that every dollar spent on necessary research and expansion may be offset by payroll tax savings.

The writer has had occasion to interview scores of Wisconsin employees who have been subject to experience rating since 1934, and has not encountered a single large firm which has not done something to avoid layoffs and provide more regular employment.[4]

Under the Wisconsin law the employer's tax rate depends on the ratio of his reserve fund to his annual payroll. By 1940 over 11 percent of the employers had qualified for the zero rate. Fifty percent paid the 1 percent rate, while the 39 percent paid rates varying from 2.7 percent up to the maximum. With the passage of each year, more and more companies are qualifying for the lower rates. Significantly, in every major industrial category and in nearly every subdivision one or more employers have qualified for reduced rates, indicating that they were making progress. While these figures

[4] Many of these investigations and those in other states are reported by the American Legion Employment Stabilization Service, Minneapolis, Minn.

are interesting, we unfortunately have no satisfactory point of comparison to demonstrate to what extent the results are traceable to natural stability and to what extent they proceed from regularization efforts. Paul Raushenbush, the Director of the unemployment compensation law of the state, who has great personal knowledge of what has happened under the law, is convinced that a substantial portion of employers are engaging in stabilization efforts. Off-season products are being developed, markets are being diversified and much more production for stock during slack periods is being carried on. Scores of other stabilizing techniques are being employed.

In June, 1940, the industrial commission of Wisconsin called a conference of employers on steadier jobs. To the surprise of nearly everyone, over 1,000 employers attended the one-day session and listened to 23 speeches, 16 of which were five-minute reports by employers drawn from a wide variety of industries, including heavy manufacturing, each describing what his problem was and how greater stability was attained. This conference itself constituted abundant evidence that employers are responding to the stabilization incentive in the law.

Mr. J. F. Friedrick, a member of the executive board of the Wisconsin State Federation of Labor, in addressing the conference, stated that organized labor will support the program if it proceeds along the lines outlined at this conference. He went on to say that if employers generally make a vigorous effort to regularize their operations, organized labor will support the program. Thus it is interesting to note that in Wisconsin, organized labor, with actual experiece under experience rating, is in favor of it, but elsewhere, where labor has had little or no experience with it, there is more skepticism.

EMPLOYERS REGULARIZE EMPLOYMENT

In his investigation the writer has found a great number of instances where formerly during the seasonal dull period a factory was completely closed down and now operates on a continuous basis. For example, a culvert manufacturing company, instead of confining production to the spring and summer period, as was the case ten years ago, now operates the year-round, although in winter it finds it virtually impossible to sell any output. A floor manufacturer who closed down his plant during the slack winter months during its entire history until about 1935, in 1939 provided year-round work for 90 percent of his employees although his sales dropped to zero in the lowest weeks.

That regularization efforts at times yield unanticipated savings is demonstrated by this company.[5] While the regularization effort of

[5] Case No. 28, American Legion Employment Stabilization Service, Minneapolis, Minnesota.

the company was under way business volume increased by 20 percent. This additional volume was produced without any increase in plant because production was evenly divided over the year. Thus, overhead costs declined 12 percent. If the new business had been producd during peak operations, plant expansion would have been necessary and the overhead savings would not have occurred.

In 1930 this company embarked upon an ambitious accident prevention program, with minor results. In 1935 the plant achieved its first major step toward stabilizing employment and in the same year achieved a greatly improved safety record. The management attributes its reduction in accidents to its regularization of employment. Keeping the same workmen permits accumulating in their minds and muscles the safety preaching and safety habits ingrained over the years. When layoffs were frequent and a large number of new faces came with each new wave of business, a large share of the preceding educational effort was lost. From 1935 to 1940 the workmen's compensation premium rate for this company declined from $5.60 to $2.40 per $100 of payroll. This was a saving of 3.2 percent of the payroll. In the same year the company qualified for the 1 percent unemployment compensation tax, thus earning a potential saving of nearly 6 percent on its payroll. Under competition much of this saving would, of course, tend to be passed on to the consumer in lower prices, but initially profits may be enhanced and the employer asserts that the regularization effort was directly stimulated by experience rating.

A building contractor has placed all his employees on an annual wage, agreeing to pay the men 24 equal semi-monthly pay checks.[6] Many similar cases could be cited.[7]

CYCLICAL UNEMPLOYMENT

To some extent the same frame of mind and the same techniques which are eliminating seasonal and casual unemployment will mitigate cyclical or depressional unemployment. Economists have consistently deprecated over-expansion on the ground that excessive booms are likely to be followed by slumps. Under experience rating, the employers expand with more caution and with better reason. This should reduce the severity of business fluctuations.

A building supply manufacturer has diversified his line to the point where now 40 percent of his raw materials are fabricated into *non-durable consumer goods,* the demand for which remains remarkably stable regardless of general business conditions. When the next depression comes this policy of diversification will provide a cushion of employment for his people.

[6] *Ibid.,* Case No. 19.

[7] For an analysis of this and many other annual wage plans see: *Journal of Business University of Chicago,* April 1941, pp. 127-149.

A window frame manufacturer, catering to the highly seasonal building industry, has completely solved his seasonal problem by carefully forecasting seasonal demands and building for stock during the slack season; but he also has adopted a "loan plan" under which during prolonged depressions employees may borrow approximately half their normal pay without interest, the loan being repayable with work during subsequent busy periods.

Several employers state that in planning research and new products they make a conscious effort to time the promotion of such new products in terms of the business cycle. Every student of business cycles knows that major depressions are attributable to many factors and no one would argue that experience rating will eliminate depressions.[8] However, it must be recognized that both business booms and slumps are caused by human decisions. The factors controlling these decisions will be modified to some extent now. Preliminary evidence suggests that experience rating is a new factor tending to mitigate business fluctuations. Formerly labor costs were viewed as prime costs which tended to vary quite directly with output. Under experience rating labor costs are to some extent converted from prime or variable costs to overhead costs. That is, labor costs are no longer completely avoidable by merely laying off the worker. For this reason employers will have a new incentive to operate continuously since, within limits, they have to pay for labor whether they use it or not.

Another factor pointing in this same direction involves a possible reallocation of resources. It is more difficult to regularize employment in the *durable goods industries* (housing, motor cars, machinery, etc.) than in the non-durable consumer goods industries. Therefore, the former will pay the higher unemployment compensation tax rates to the extent to which unemployment cannot be avoided; the products of these industries will tend to rise in price; consequently less labor and capital resources will be devoted to producing these products, the consumption at these higher prices having decreased. This should encourage the absorption of relatively more labor in the non-durable goods industries where prices can be relatively lower and thereby encourage greater stability in the economy as a whole. How important this factor, making for greater stability, will be is not known at this time.

Furthermore, as the stabilization movement grows it will become progressively easier to regularize employment in difficult situations. For example, due to the stability of income enjoyed by the Hormel Packing Company employees, the building industry in Austin, Minnesota, has become relatively stable. One employer acting alone and faced with a highly unstable market may be able to make only limited progress toward regularization. But the simultaneous action of all employers will produce entirely different results. Economic

[8] Estey, James A.: *Business Cycles*, 1941, Prentice-Hall, New York.

historians tell us that one reason for the great industrial progress of Great Britain in the 18th and 19th centuries was the comparative political and economic stability of the islands while the continent was rocked with wars and other disturbances. Every additional element of stability which can be added to the economy should make further steps in that direction more easy and encourage the absorption of the unemployed.

In terms of the so-called acceleration principle [9] any additional stability attained in the consumer goods industries should be transferred in somewhat more than direct proportion to the durable goods industries thus adding a further element of stability to the total economy.[10]

Regularized employment will unquestionably reduce the pressure to raise hourly wage rates. Although labor is not a commodity, labor power is bought and sold and is subject to economic law. If hourly wage rates become unduly high, this encourages unemployment. A Wisconsin contractor under pressure of experience rating adopted a guaranteed annual wage plan for all his building mechanics. He guaranteed his men about $250 more *per year* than they had been earning, but by working them virtually the year-round he got the hourly rate and his labor costs reduced by nearly one-third. A very important labor leader in the Middle West stated to the writer that labor would gladly give up a part of its *hourly* income if it could obtain more steady employment. An official of the Wisconsin State Federation of Labor testified in the spring of 1941 before one of the legislative committees that labor was more interested in employment regularization than in benefit payments. All this suggests that as employers provide more regular employment, it will become progressively easier to absorb our labor power into productive enterprise at wage rates which will not encourage unemployment.

CONCLUSION

Irregular employment and hiring by the hour or day have been the experience of most American workers. Under experience rating, new incentive for employment regularization is provided for perhaps 1,000,000 American employers. Time is required for adjustment to these new objectives of regularized work and payment. In a world torn by war and international disturbances, not too much can be expected at present. However, most of us have been too complacent in blaming international disturbances for our own internal instability, when as a matter of fact internal stability and

[9] Estey, *ibid.*, pp. 169-178.

[10] For a more complete analysis of this and the preceding point see: Lindblom, Charles E.: "Long Run Consideration in Employment Stabilization and Unemployment Compensation," to be published in the *Quarterly Journal of Economics*, November, 1941.

prosperity may go a long way toward encouraging external or international stability and prosperity. A strong, stable, and productive America, because of its great size, has a contribution to make toward international stability and prosperity. We are just at the beginning of this movement toward employment regularization. While substantial progress is already being made by the more forward-looking employers, we must recognize that time and educational effort are required for further attainments.

If experience rating is given a fair chance, it may go a long way toward eliminating a substantial margin of insecurity, and may do its part in preserving our historical liberties and freedom.

Other forms of incentive taxation are largely in the discussion stage. The von Papen plan was tried on a modest scale under unfavorable circumstances in Germany in 1932.[11] With the comprehensive payroll records now required under unemployment compensation laws, the additional administrative problems involved should not be great, once a sound theory and plan of further taxation incentives have been worked out.

INCENTIVE TAXATION WITH SPECIAL REFERENCE TO UNEMPLOYMENT

CHARLES L. HOFFMAN

Vice-President, Minnesota Employers Association

After listening to the previous speakers I feel just about as essential to this program as the Social Security Board seems to think our state legislatures are to the unemployment compensation program.

Mr. McCullen mentioned that one objection to experience rating in unemployment compensation is that most of the discussion before legislative committees centered around experience rating to such an extent that adequate consideration was not given to providing proper benefits. He did not, however, explain the reason this may be true. Here it is: There is seldom any serious argument over the general plan of determining an individual employer's experience. The argument arises over the question of who should be eligible for benefits. I do not see how this argument can be avoided so long as the Social Security Board and certain others continue to demand that benefits be paid to workers who have only themselves to blame for their unemployment. This law was originally conceived and adopted to protect workers who became unemployed through no fault of their own. It is when attempts are made to use funds provided by employers to pay benefits to those who have brought about their own unemployment that objections are raised. Unemployment compensation is insurance—provided to bolster the economic situation during a

[11] Poole, Kenyon E.: "Tax Remission as a Means of Influencing Cyclical Fluctuations," *Quarterly Journal of Economics*, February, 1939.

period of emergency. It is not a huge fund from which payments should be made to any every person who may be unemployed for any reason whatever. It cannot and should not be expected to replace direct relief and solve all the social problems.

Actually, I believe we are faced with a problem which is even more serious than that of experience rating. There has, for several years, been an ever-increasing trend on the part of the Social Security Board to seek greater control over state unemployment compensation systems. Complete federalization is now ominously threatening. Why should this be sought? When the federal unemployment compensation law was first passed it provided a 3 percent federal tax on payrolls and provided that a 90 percent credit would be allowed for contributions made into a state unemployment compensation fund. The states were not required to pass such laws nor were there many requirements as to how state laws should read. The 90 percent credit was a concession—certainly not to be construed as coercion! Oh no! It " just happened " that all the states rushed onto the band wagon—called special sessions of their legislatures in many cases—and rushed through a law that, in most states, was almost exactly like the draft bill prepared by the Social Security Board. That was the first hurdle.

Each year thereafter the Social Security Board wanted to go a little further, wanted benefits paid to more workers than originally intended, higher benefits, more coverage, longer duration of benefits, shorter waiting periods, less severe disqualifications—in fact—simply slightly longer waiting periods rather than a disqualification. But employers were learning too, and they developed some ideas as to how their tax money should be spent and who should control it—and they didn't favor the Social Security Board for that purpose—and still don't. Employers are willing to provide protection—adequate protection—for their workers who have to be laid off because of lack of work. They are willing to assume their own responsibilities. They believe that their own state legislatures are capable of handling the situation. Rather than more federal control—we need much less of it.

Apparently this same feeling is prevalent among the state unemployment compensation administrators. I recently attended the Interstate Conference of Employment and Security Administrators, Unemployment Compensation and Placement Directors at Nashville. Almost without exception, those people are bitterly opposed to federal encroachment. They even passed a resolution whereby each administrator will seek an appropriation from his own state to finance that state's participation in the Interstate Conference so that the conference may thus be free from Social Security Board domination and no longer a " company union." May I suggest that it is the duty of each of us to support our state administrators in their demands. They deserve every bit of help we can give them.

Every effort in every state should be directed against further federal control. Federalization means a complete sacrifice of states rights —probable elimination of experience rating—indiscriminate benefit payments and more and higher payroll taxes.

EXPERIENCE RATING AND OTHER FORMS OF INCENTIVE TAXATION TO PROMOTE EMPLOYMENT

CHAIRMAN WITTE: Concluding this session it may be apropos for me to briefly state my views on the subject we have been discussing, particularly as several of you have directed questions to me.

As I have always looked upon unemployment compensation as an insurance institution, designed to give workers normally employed a partial wage for a limited period after being laid off, until they find other work or, more commonly, are called back to their old jobs, I must confess that I have found the approach to experience rating as incentive taxation, which we have been pursuing tonight, somewhat strange. I recognize, however, that it is an entirely proper one. The employer's "contributions" to unemployment compensation funds (as they are called in the laws of most states) may be, as I believe, more in the nature of insurance premiums than taxes, but they are popularly called a "payroll tax" and the recent tendency has, undoubtedly, been to emphasize the tax aspects of unemployment compensation more than the insurance aspects which was the original concept.

Professor Schmidt opened vistas of the use of taxes as an incentive to private industry to provide increased and more regular employment which are much broader than experience rating in unemployment compensation, although this is the only such incentive device now in operation. I am not prepared to discuss the several possibilities to this end outlined by Professor Schmidt; much less to suggest still other incentive taxes which might be utilized to increase employment, although I am satisfied that there are other measures that might profitably be considered. I merely want to record my agreement with the general line of thought which Professor Schmidt developed in the early part of his paper.

I agree with Professor Schmidt that it is doubtful whether this country, and particularly its democratic institutions, could survive another such period of mass unemployment as we experienced in the great depression. Despite the present boom, the problem of insuring full employment on a lasting basis, remains our number one domestic problem, which is likely to break out again in an acute form following the war. Unemployment insurance, as well as every other institution for the benefit of the unemployed or which affects employment opportunities, needs to be judged on the basis of what it can contribute to the solution of the fundamental problem of se-

curing and maintaining full employment. Unemployment insurance, with or without experience rating, is not the complete answer, but, I believe, is an essential step toward the solution of the unemployment problem.

Quite obviously other measures are also necessary. Incentive taxation, including devices yet untried, merits consideration in this connection and seems to me to be sound, at least in theory. Incentive taxation is in line with the older progressive philosophy in this country. This philosophy aimed not at the displacement of our so-called "private capitalistic economy" by a governmentally directed economy, but at the re-vitalization of our economy of free enterprise. In this progressive philosophy, indirect incentive devices, utilizing the profit motive of the entrepreneurs, were deemed more desirable than direct control measures, while governmental operation was thought of as suitable only within very limited fields and as a last resort.

More recently, there has developed strong support in the country, particularly in Washington circles and among economists serving as advisers to government agencies for what is called "a planned economy." This is an economy controlled in all essential details by the national government. While retaining private property and some degree of freedom of choice of occupations and investment, it contemplates central direction of all enterprises.

In such an economy indirect incentives can be of but little value. They are too uncertain to be useful for the detailed direction of industry. For a centrally controlled economy, resort must be had to such direct measures as extensive governmental investment and employment priorities, price controls, the rationing of consumption, and ultimately, as I see it, the conscription of both labor and capital. In such a "planned" or "controlled" economy, individuals have little free choice, yet are important to the state because no economy can be maintained without the labor of the men and women of the nation. So while they approach all problems from the point of view of control of the entire economy, they, too, believe in social security measures, as essential to the productive efficiency of the nation. But to them social security means nothing more than the maintenance of the working population to insure maximum efficiency. Unemployment compensation is but another form of relief, and society as a whole should pay the costs.

This approach to social security has a strong appeal to labor and to many of the underprivileged. "Work or maintenance" is the slogan of the British socialists, and in this country there are many people who put "maintenance" ahead of "work." Interestingly enough, one of the slogans on which Adolf Hitler rode into power in Germany was "*Volksversicherung nicht Sozialversicherung*"—maintenance of the population, not social insurance. This is, in-

deed, an appealing concept; at first sight, it seems to be all in favor of the underdog.

This is not the concept of social security of the people who had most to do with giving us the Social Security Act. Among the early advocates of social insurance, none were more conspicuous than Dr. John R. Commons and the late Justice Louis D. Brandeis. These two men were the very people who first advocated varying contribution rates in unemployment insurance, to the end that this institution might serve as not a mere relief measure, but as an incentive to the regularization of employment. This idea came not from reactionaries or business leaders, but from outstanding progressive thinkers. When the Social Security Act was under consideration in Congress, President Roosevelt urged that any provisions made for unemployment insurance should be directed toward stabilizing employment, not toward mere maintenance of the unemployed. That was the position also which the American Federation of Labor took when, in 1932, it reversed its former stand in opposition to unemployment insurance. The provisions in the Social Security Act permitting experience rating were vigorously supported at the time by the present chairman of the Social Security Board, and the sections on this subject in the laws of most of the thirty-eight states which provide for experience rating were copied verbatim from model bills prepared by the Social Security Board. Some of these may have changed their ideas since, but it is worth remembering that the concept of experience rating in unemployment compensation came from progressives and was pushed to enactment by them. Very definitely, it is in line with what might be called the progressive thought and traditions of this country.

It may be that progressivism is now outmoded, that we should aim, not at revitalizing our economy of free enterprise, but at substituting for it a governmentally controlled economy. In wartime we, undoubtedly, must have a large measure of governmental direction of our economy. We have to accept such things as defense unemployment at the very time when we need to utilize all of the labor and capital we have to defeat the Nazis, because economic planning has been defective. Great as may be the risks of such errors and the costs which government control of our economy may entail, nearly everyone will agree that to defeat Hitler we must adopt at least some of his methods. But an economy, which in peace as well as in wartime, is controlled in all respects by the national government is quite another matter.

The glowing picture painted by the planners, of an economy in which there is always full employment and maintenance, at an American and rising standard of living, is very attractive. But what has happened in Germany may well give us pause. Hitler's planned economy, with its "*Volksversicherung*" (maintenance of the entire German population by the state) was attractive alike to

the great industrialists, the petty shopkeepers, the farmers, and many of the workingmen; but it has meant the wiping out of all real distinctions between private and public property, compulsory labor, and the complete loss of personal freedom, as well as plunging the entire world into a holocaust of war. I do not suggest that the advocates of a planned economy want to create such conditions as prevail in Germany. I grant their sincere patriotism and their desire to make this a still better country for all our people. But I cannot go with them in seeing the solution of the employment problem in complete governmental control or in looking upon social security as maintenance at public expense. To me social security remains a group of institutions to take care of the needy, but, above all, to decrease the need for relief by making the widest possible use of insurance principles and encouraging industry to do its utmost to provide employment. Indirect incentives may seem less certain than direct measures of control and extensive participation in industry by government itself, but they seem to me worth trying in the fullest degree possible. There are great values to be gained if we can preserve our economy of free enterprise, and above all, many reasons to fear a completely planned and controlled economy.

Viewing unemployment compensation as basically an insurance institution, I believe that experience rating is necessary to equitably distribute compensation costs. Experience rating amounts to an attempt to adjust the employer's contribution (or premium) rates in accordance with the costs to the unemployment compensation funds occasioned by unemployment among the employees of the respective employers. In all types of insurance, at least in this country, the premiums charged a particular risk reflect the actual or estimated costs of carrying that risk. That seems to me to be the fair way of distributing costs—whether or not a given employer has done anything to either increase or decrease the costs for which he is responsible. Just as each employer must pay his own wage bill, without looking to the public or other employers to pay all or a part of this bill for him, it is equitable that he should also pay the partial wages we call unemployment compensation, which are payable to workers he has laid off and who constitute his labor reserve.

In theory at least, also, experience rating is justified as a measure of incentive taxation. It is socially highly desirable that employers should stabilize their employment. They cannot do so perfectly; some of them perhaps not at all; but there is ample evidence that many employers acting separately can do a great deal to reduce the intermittancy of their employment, and, as Professor Schmidt has suggested, we cannot know what might be accomplished by something like a concerted effort to regularize employment, if employers were encouraged to make such a concerted effort. The statements made by the opponents of experience rating that employers try in every manner possible to keep down their contribution rates, is

clear proof that the incentive in this case is very strong and that experience rating does make a difference in employment practices.

Justified doubts about experience rating arise, not from its theory, but from its operation. As Mr. McCullen and others have developed, there are some results of experience rating in concrete cases which have no logical justification. That experience rating does not work perfectly is not surprising considering its newness. In all insurance, the rates are never perfectly adjusted to the risks. But while defects are understandable, they deserve serious attention. Experience rating as thus far developed, is defective in that it does not accurately measure differences in costs and in making it possible through various devices, most of them anti-social, to reduce compensation costs without decreasing unemployment. If experience rating is to continue, it needs to be improved. The Social Security Board should furnish leadership to this end, but all who believe in experience rating should be on the alert to make it a better instrument for making the contribution rates equitable and as an incentive to reduce, not merely compensable unemployment, but all unemployment.

It is my hope that experience rating may be given a real trial and that a major effort will be made to make it a fairer and more serviceable institution. Its abolition by action of Congress would be strongly resented by employers and would be grossly unfair to stable employers and industries and to the states in which such industries predominate. It will work, not to promote national unity, but to create resentments interfering with our maximum defense effort. To destroy experience rating, by fiat from Washington, would be a sad mistake; to improve experience rating is a vital need. As an old-fashioned progressive, I believe in incentive taxation, although more direct measures to insure full employment may be more appealing.

FOURTEENTH SESSION

WEDNESDAY, OCTOBER 15, 9:10 A. M.

Spanish Room, Lowry Hotel

SETH T. COLE, presiding.

CHAIRMAN COLE: The conference will please come to order.

There is one thing I like about the National Tax Conferences. They have the ability to get things accomplished. For example, there has been a great deal of discussion, as we all know, as to whether or not Canada should be made a part of the United States, a problem that has been discussed on both sides of the border, and varying conclusions have been reached. But the National Tax Association has no difficulty with a problem of that kind. When the rules to govern this conference were adopted, they solved it by merely adopting a rule which provided that the word "state" oi the United States included any Canadian province.

The subject this morning is excess profits. A client of mine made the inquiry a short time ago as to whether or not the excess profits tax would be repealed after the current emergency is over. I told him I didn't think there would be any necessity for repeal.

We have heard a great deal about tax-consciousness in the past. The effort has been to make the people tax-conscious. It seems to me that the excess profits tax is aimed in exactly the opposite direction: the design is to make people tax-unconscious.

I don't know what the report of the committee contains, or what they have to offer to us. It is in the nature of a preliminary report. The committee is composed of distinguished scholars in the field, under the very able leadership and chairmanship of Professor Thomas C. Lavery of Cincinnati, and the first order of business this morning will be to give the floor to Professor Lavery for the rendition of his report.

PRELIMINARY REPORT OF THE COMMITTEE OF THE NATIONAL TAX ASSOCIATION ON EXCESS PROFITS TAXATION

THOMAS C. LAVERY, CHAIRMAN

The National Tax Association, at its annual conference held in New York City in September, 1940, adopted a resolution which reads:

"Be it Resolved, that the president of the National Tax Association be directed to appoint a committee of twelve to study the problem of excess profits taxation in its relation to emergency and normal finance and its effect upon state and local revenue structures; and that such committee be directed to report to the 1941 conference."

In conformity with this resolution the committee appointed by Hon. A. J. Maxwell, president of this Association, begs leave to submit this, a preliminary report, and to ask that its life be continued for another year.

It will have been noted that the resolution calling for the appointment of a committee to study the problem of excess profits taxation sets forth the subject of its deliberations in rather broad terms, namely, the relation of excess profits taxation to emergency and normal finance and its effect upon state and local revenue structures. However, the turn of events since the adoption of the resolution and the appointment of the committee has led it to believe that consideration of that phase of the problem relating to the effect of the federal excess profits tax upon state and local revenue structures should not be undertaken at this time. Undoubtedly a heavy tax upon excess profits will have a serious impact upon the tax bases used by the states to support their revenue systems, since it will inevitably diminish the resources of corporations and individuals from which state and local taxes must be paid. At the same time, however, it has seemed to the committee that no one is now prepared to maintain that the revenue structures of the states and localities must be radically changed if the federal government continues to resort to excess profits taxation. At least for the present there does not seem to be any very definite forcing action in that direction. Moreover, another committee of this association, of which Hon. Henry Long is chairman, is studying the problem of the effect of federal taxes of all kinds upon the setup in the states. When that committee is ready to report, it will no doubt include as one of its major subjects the relation of the federal excess profits tax to the sources of state taxation.

Likewise, for the present at least, the committee has felt that it should confine its study to the problem of excess profits taxation in a period of national emergency. Whether or not a period of "normal finance" will ever recur, or whether or not we shall ever be without some kind of a "national emergency" are matters upon which the committee as a whole has not expressed an opinion.

On July 1, 1940, the President sent a message to Congress recommending the enactment of a "steeply graduated excess-profits tax, to be applied to all individuals and all corporate organizations without discrimination" so that no citizen should make any abnormal profit out of national defense. In compliance with this recom-

mendation the excess profits tax act of 1940 was passed. In the opinion of the Treasury Department, however, that act did not reach its objective; on the contrary, it was defective in two respects, first, it failed to reach large parts of defense profits because of the allowance of the minimum eight percentum invested capital credit; and, second, it failed to reach profits in excess of a necessary normal return on invested capital because of the provision of a credit for every corporation equal to 95 per centum of its base-period earnings, regardless of the size of those earnings in relation to invested capital.

In the hearings on Revenue Revision of 1941, before the Ways and Means Committee of the House of Representatives, Hon. John L. Sullivan, Assistant Secretary of the Treasury, outlined the principles which he believed should govern the taxation of excess profits, indicated the respects in which the 1940 act had failed to accord with those principles, and suggested possible remedies which the Congress might wish to consider. In his opinion two types of profits in a period of war emergency should be taxed: first, profits which may reasonably be attributed to a defense program; and second, profits in excess of a necessary normal return on invested capital, even though such profits had been earned in years prior to the beginning of the defense program. To reach these two types of profits he then suggested the elimination of the base-period earnings credit and a reduction in the eight percent credit on invested capital.

Before the passage of the Revenue Act of 1941, the Treasury saw that handwriting was beginning to appear upon the Congressional wall. On July 31, 1941, the President wrote to Hon. Robert L. Doughton, Chairman of the Ways and Means Committee of the House, that

> "Because of some uncertainties which seem to have developed in regard to the position of the Treasury Department in regard to some provisions in the tax bill as reported out by the Ways and Means Committee, I asked the Treasury Department for a clarifying letter, and I think it is only fair to send this to you."

This clarifying letter to the President, signed by Secretary Morgenthau, dated July 31, 1941, reads in part as follows:

> "* * * The Treasury has consistently adhered to the position that the excess-profits tax should apply to profits in excess of a reasonable return on invested capital. Many corporations between 1936 and 1939 (the base period) earned average profits far in excess of a reasonable normal return. Nevertheless, the pending bill exempts all such earnings from excess-profits taxation unless they are more than 95 percent of the average profits earned in the 1936 to 1939 period."

And he concluded:

> "Therefore, in another important respect the pending bill is inconsistent with the Treasury's clearly announced purpose."

In his reply to the President's letter, Mr. Doughton acknowledged that there were differences of opinion as to the proper base for measuring excess profits; and stated that for that reason the question had been thoroughly reconsidered by the members of the Committee. Nevertheless, he added, it had voted overwhelmingly to reject the Treasury proposal. He wrote:

> "While a corporation's return on invested capital may seem large in some instances, and this is especially true in the case of a business, which has grown from a humble beginning, it does not follow that such a corporation has realized excess profits. The difficulty is that experience has shown that invested capital is not a proper base for measuring excess profits in many cases. Our studies and the overwhelming testimony of witnesses before our committee has convinced us of the undesirability and inequity of measuring excess profits by the sole standard of invested capital. The experience of this method in the last World War and its abandonment by foreign countries show that it does not determine the excessiveness of profits even reasonably well.
>
> "I feel that no one would be inclined to favor the corporation which had retained its earnings over a long period of time, as against the corporation which distributed its earnings and thereby permitted the Government to secure the individual normal and surtaxes on such earnings. Or to favor the company which by chance was incorporated in a year of high values, as compared with a company organized in a year of low values. Or to conclude that the present shareholders of a corporation have realized an excess profits (sic) on what the original shareholders paid for their stock. Or not to give recognition to factors of personal efficiency as well as capital in determining the measure of excess profits. Yet it was demonstrated to our committee that not only these but other inequities existed under a straight invested-capital method, which would prevent such an excess-profits tax from operating fairly on the basis of ability to pay. To punish the small corporation in favor of the heavy or over-capitalized corporations would punish conservative corporation finance and reward stock watering. It would put a penalty on brains, energy, and enterprise, and confirm old ventures in their monopolies."

As enacted by Congress, the Revenue Act of 1941 retains the excess profits tax structure which was embodied in the Second Revenue Act of 1940, and permits the use of alternative methods, the in-

vested capital methods and the average-earnings method, as the standard of measuring whether the profits of the taxable year are "excessive," that is, in computing the excess profits tax credit. Any corporation organized prior to January 1, 1940 is entitled to use the method which results in the lesser tax. Under the income credit method, the standard of measuring excess profits of the taxable year is the average income during 1936-1939, called the base-period. Ninety-five percent of such average, adjusted for capital changes during the taxable year, is the excess profits credit based on income. The invested capital credit is eight percent of the amount of the invested capital up to five million dollars and seven percent on the remainder of the invested capital. Invested capital is in substance the total paid-in capital of the corporation plus the accumulated earnings and fifty percent of the borrowed capital.

The excess profits tax is computed on profits before deduction of income tax and is deductible from income in computing the income tax. This method represents an important reversal of tax deductions from the 1940 law and a return to the method provided by the 1918 law.

Against this summarily stated background the committee has considered three general questions: (1) is an excess profits tax a proper form of tax under any circumstances in a capitalistic economy? (2) if so, can the factors which objectively characterize profits as being "excess" be isolated? (3) if so, how can such excess profits fairly be taxed?

There are numerous other questions of a more specific character which must be answered in the process of considering the three general questions just mentioned. Among them are the following:

Should an excess profits tax apply to profits made out of the defense emergency or should it apply to profits made during the defense emergency regardless of their relation to that emergency? This, brushing aside administrative difficulties and questions, is the basic issue between the administration and Congress over the taxation of high profits above a percentage return on invested capital.

In an emergency such as this should all industry be treated in essentially the same manner as public utility industries are treated in normal times, namely, by imposing some limitation, partial or complete, on the rate of profit which they may earn?

Is the excess profits tax better or worse as an instrument of inflation control than the general corporation income tax or other forms of taxation?

Should excess be considered from the viewpoint of equity with respect to the past or from the viewpoint of the necessary return for enterprise and efficiency in the future, and is there any basic conflict between these two viewpoints?

Should unincorporated businesses be subject to the excess profits tax and if so how should their invested capital be measured?

Should excessiveness of profit be considered from the viewpoint of the stockholder who now holds the stock or from the viewpoint of the corporation as a business entity?

Should one year, two years, or a long period of years be included in averaging up the profits to arrive at excessiveness? Particularly, should there be a recomputation of profits during the emergency after the emergency is over and the readjustments are made?

Should the excess profits tax apply to rewards for personal services and if not how may the personal service element be segregated and eliminated in computing profits?

Should there be special consideration to variations in the risks existing in different businesses, or would a long period of averaging make special consideration of risk unnecessary?

To what extent are the desired perfections of excess profits taxation impossible of achievement because of administrative difficulties, for example, in the determination of invested capital?

Not all of these questions are of equal importance and they have been listed without regard to logical order, but they may be helpful in indicating the complexity of the problem which has been assigned to the committee.

As yet the committee has no evidence from which it may find that the administration has given any thought to the excess profits tax as a permanent peace-time addition to the federal revenue system. As far as can now be discerned, no one in official position stands in the shadows saying to himself that the excess profits tax will be a fine tool either for the raising of revenue or the regulation of business enterprise ten years from now. It stands purely as an emergency measure.

In a time of threatened or actual war there is, no doubt, a substantial unanimity of opinion behind the administration's position that people ought not to make great fortunes out of the exigencies of war; and that therefore some device must be employed effectively to prevent the achievement of this end. When unorganized manpower is being drafted there can be no valid ground on which capital, to say nothing of organized labor, or agriculture, may claim exemption from sanctions which seek to distribute the heavy burden incident to a defense effort. But the problem should not be settled simply by saying that a tax on the profits must be exacted to satisfy or allay popular clamor; the reasons, if any, which make the objectives of such a tax worth pursuing for its own sake must be sought.

As a state of actual war approaches, everything must of necessity bow to the supreme importance of maximizing the war potential. To get the full cooperation of conscripted manpower and perhaps of organized labor, there must be a like conscription of excess profits. However, it must not be forgotten that an excess profits tax, if pushed too far, may seriously impair the incentive to pro-

duction and efficiency. On the other hand, a threatened or actual state of war so disturbs conditions of supply and demand that there is literally a condition of economic upheaval. It is then more likely than not that there will be people who may make fortuitous profits without any defensible contribution. Certain people have stocks of something for which the demand quite unexpectedly on their part becomes great and certain other people are in a strategic position to make things profitably. Clearly, as to these, an excess profits tax may be desirable. As a war measure, therefore, it sems not only inevitable, but under present conditions of lack of absolute control of prices, desirable to have some kind of an excess profits tax. But the extent to which this tentative conclusion remains sound will depend upon how far price fixing and priorities may reduce the opportunity to realize excess profits, or indeed, profits of any kind in business undertakings.

The hearings before the Committee on Ways and Means of the House and the Finance Committee of the Senate, and the Roosevelt-Doughton correspondence, show there was a sharp difference of opinion between Congress and the Treasury Department as to the method of measuring excess profits. However, despite the objections of the President and the Treasury Department, Congress, in enacting the Revenue Act of 1941 closely followed the pattern of the Excess Profits Tax Act of 1940. There can be no doubt that the administration and the Congress, each in its own way, was attempting to devise a method by which " fairness " among all classes of taxpayers could be achieved. Indeed, in his letter to the President, Mr. Doughton said, " Our committee believes that the excess profits tax plan in the pending bill is the fairest which could be devised." But since the Treasury Department did not share this view, it is manifest that these competing ideas rest upon fundamentally different views of fairness.

In the report of the Committee on Ways and Means of the House of Representatives, which accompanied H. R. 5417 when it was presented to the House, the major objections which that Committee found to the Treasury plan are set forth. It was said that a method for computing excess profits based upon invested capital alone would penalize some corporations as against their competitors. For example, a corporation organized in a period of low values would be discriminated against in favor of a corporation organized in a period of high values, although identical assets may have turned in to each corporation. Similarly, that method alone would favor a corporation which had distributed little or no dividends in the past as compared with a corporation which had pursued a liberal dividend policy. It would also penalize the stockholders who had paid for their stock on the basis of the present worth of the corporation. And finally, the committee found that the employment of the invested capital method alone was objectionable in that it gives no

recognition to the fact that many businesses have been conservatively capitalized or built up, especially the smaller ones, not mainly from capital but from good management, skill, deveopment of good will, favorable locations, trade advantages, and other important factors of personal efficiency. It was not, however, prepared to abandon the use of the invested capital method as an optional base because it did provide a yardstick for those corporations which either had no base-period income or were operating on a subnormal basis in the base-period.

The chief objections of the Treasury Department to the Ways and Means Committee plan (overruled by the Congress in the enactment of the Revenue Act of 1941) were, first, that it left large amounts of "excess" profits exempt from taxation; second, that it tended to encourage monopoly; and third, that it discriminated against competitors of prosperous established corporations. The theory underlying the committee's plan seems to have been that only extra profits due to defense expenditures, "defense profits," rather than "excess profits" defined by reference to invested capital should be taxed, since by the use of the earnings method as the direct measure of defense profits only the increase of earnings in the taxable year over the earnings in the base-period were called "excess" and taxed. Thus, the Treasury questioned the two basic assumptions of the committee, first, that the earnings in the base-period were "normal;" and second, that the increase is "excess" or due to defense expenditures, on the grounds respectively that a base period that is normal for corporations as a whole is almost invariably abnormal in varying degrees for corporations individually; and that since there was no reasonable factual foundation for the belief that the increase was "excess" or due to defense expenditures, recognition was denied to the sound principle of ability to pay flowing from the receipt of large amounts of non-defense profits.

With the divergent views of Congress and the Treasury Department before us, we return to the question, by what standard or standards may we determine objectively what is a "fair" excess profits tax? Before we can say what is fair, we must examine the philosophy which underlies the tax. Are we to abandon the profit motive entirely or to abandon it only as to profits directly attributable to the defense effort. "There is no satisfactory way," said Senator La Follette in expressing his individual views on the excess profits tax bill when it was reported out of the Finance Committee to the Senate, "of distinguishing between defense profits and other profits. No chemical test can be applied to make a precise separation. Dollars lose their identity when flowing through the economic system. Products which have an important use in the defense program may have a simultaneous important use in normal industrial activity. Paint for a battleship is the same as paint for industrial machinery. Shoes for the Army are the same as shoes for the far-

mer. Even with complex accounting systems no satisfactory separation of profits can be made." Thus, an excess profits tax which will be " fair " when applied to corporations whose profits are attributable directly to the defense effort, may operate unjustly and inequitably when applied to the profits of corporations derived from activities only remotely connected, if at all, with the defense effort, unless the statute provides for special relief in such cases.

Apparently, as far as Congress is concerned, there is no disposition to use the excess profits tax as the weapon with which to destroy the profit motive. The premise underlying the Revenue Act of 1941 seems to be that corporations are entitled either to earn a normal return upon their invested capital or an amount equal to their earnings during the base-period before being subjected to excess profits taxation. In other words, irrespective of the source of such profits, whether derived directly from defense activities or not, Congress has acted upon the assumption that the realization of some profits may and probably does tend to stimulate the defense effort.

Of course, it is not inconceivable that circumstances may arise which will render this view untenable. A state of actual war may create a situation where all hope of profit may have to be foregone. Certainly, if the existence of the nation is jeopardized, there will be neither time nor place to argue about profits, to say nothing of the base for measuring excess profits by either or both of the methods which have been adopted.

The term " profit " includes a return for risk which varies a great deal from situation to situation. A corporation which goes into a risky venture may do so with the expectation that sometimes it will make one hundred thousand dollars above the line. But it is running an equal risk at another time of making one hundred thousand dollars below the line. And, therefore, to the extent that any part of the hundred thousand dollars above the line is taken, the incentive to go into risky occupations is not only theoreticaly, but actually impaired, as compared with those which have the prospect of an even return regularly throughout the year. Therefore, unless the government is willing to undertake the function that the profit system performs more or less automatically, namely, to underwrite risks, it cannot too closely shave off profits without setting into operation forces that cause distortion in what would normally occur in the selection of certain undertakings.

Under the 1941 act, many situations will occur in which the problem of " fairness " in the application of the excess-profits provisions will be presented. A few of the obvious cases may be summarized:

(1) Corporation A, large invested capital, high base-period earnings;

(2) Corporation B, large invested capital, low base-period earnings;

(3) Corporation C, small invested capital, high base-period earnings;

(4) Corporation D, small invested capital, low base-period earnings;

(5) Newly organized Corporation E, large invested capital, no base-period earnings, high taxable year earnings;

(6) Newly organized Corporation F, small invested capital, no base-period earnings, high taxable year earnings;

(7) Newly organized Corporation G, large invested capital, no base-period earnings, low taxable year earnings; and

(8) Newly organized Corporation H, small invested capital, no base-period earnings, low taxable year earnings.

Each of these situations can be affected by assuming that the corporate earnings flow from (a) direct participation in the defense effort; (b) indirect participation in the defense effort; or remote participation in the defense effort because of the rise in national income.

A casual consideration of the cases stated at once discloses the inequalities in the application of the excess-profits tax provisions of the Revenue Act of 1941. For example, that act permits corporations with large invested capital to make large profits without tax, irrespective of the size of their base-period earnings or of the source from which they are derived. At the same time, it permits corporations with small invested capital to continue to make large profits without tax, if they had earned as much during the base-period. But compare the position of a newly organized corporation, where invested capital is small and where taxable year earnings are high because of the presence of factors other than invested capital. There the excess-profits tax may take its heavy toll, irrespective of whether they represent participation in the fruits of the defense effort or not.

Acceptance of the view of the Treasury or the Congress, singly or in combination, however, does not remove many of the obstacles which beset the path of an excess-profits tax. For example, what the average earnings of a corporation were during the base period may be hard to determine. In the case of large corporations there may be many disputed items to send the average up or down. Similarly, the determination of the invested capital of a corporation may be a difficult, if not actually an impossible task. The taxpaying company may have been the result of many reorganizations, consolidations, mergers, and the like, involving changes in the corporate structure which may or may not have been tax-free. And even if such questions can be answered, there may be further questions as to the taxable year in which the changes occurred.

The complicated nature of changes in corporate structures also tends to reveal the weakness of the administrative process by which

most tax cases are settled. When every issue in every case must be determined upon a meticulously precise basis, that is, fought out in the way in which lawyers are accustomed to fight out issues in the courts, then the overwhelming volume of work requires a veritable army of experts for its performance. Today the trend in administrative methods seems unquestionably to be in that direction.

In his statement before the Ways and Means Committee, Mr. Sullivan, after outlining the Treasury position, said:

> "If these principles are not to be the guide for taxing corporations during the emergency period, it would be well to bear in mind the disadvantages of the tax in its present form, which involves the administrative difficulties inevitably accompanying excess-profits taxation but fails to tax large amounts of profits that it properly should reach. A simpler, more easily administered plan would, of course, be to abandon the excess-profits tax and to increase the corporation income tax by enough to produce the desired revenue."

This suggestion seems to be in line with the plan proposed by the committee of the National Tax Association on Federal Taxation of Corporations, in its final report presented at the Thirty-Second National Tax Conference, held at San Francisco, in 1939.

Finally, the effect of sanctions stemming from governmental powers other than the power of taxation, such as price control, and the like, must be considered. To the extent that the employment of these regulatory devices is increased and broadened, the importance of the role played by the excess profits tax as a revenue producer will be diminished and narrowed. Universal price control would, of course, freeze profits at a given level and thereby tend to eliminate the need for an excess profits tax and a system of priorities would not only narrow the field for making profits but would also in the case of businesses regarded as non-essential to the defense effort suspend their activities entirely. If the bill now pending in the Senate, "To further the national defense and security by checking speculative and excessive price rises, price dislocations, and inflationary tendencies," or a similar measure is enacted into law, a reexamination of the excess profits tax would seem to be in order. As far as the committee has been able to ascertain, however, no coordinated plan for price control, priorities, and the excess-profits tax has been considered. Apparently proposals continue to come from many directions, each with its own ends to pursue, and entirely oblivious to the objectives of the others.

As inequalities and injustices appear in the 1941 act, the demand for amendment or for special relief will increase. The tax section of the American Bar Association has a committee, under the chairmanship of Robert N. Miller, Esquire, of Washington, D. C., which is doing prodigious work in ironing out the wrinkles in the law.

But it does not deal in generalities as this report has done; it gets down to cases of patent unfairness in the operation and administration of the law. Whether this committee should undertake such an ambitious program is open to grave doubt, in view of the purposes for which the National Tax Association was formed. It should, however, continue its study of the questions raised but not adequately answered earlier in this report and it should present the experience of other countries where the excess-profits tax is a part of the revenue system. For that reason, the Committee asks that its life be extended for another year so that it may have the opportunity to give further study to the effectiveness of the excess-profits tax, although the chaotic world in which we live seems more and more to leave the inquiring mind a blank.

CHAIRMAN COLE: I am sure we are indebted to Professor Lavery and to his committee for this very fine preliminary report, which we must agree shows that there is a vast field for exploration and for further work. The discussion of the report will be led by John L. Connolly, Secretary of the Minnesota Mining and Manufacturing Company, of St. Paul, and a member of the local committee of arrangements for this conference.

Mr. Connolly.

JOHN L. CONNOLLY: Mr. Chairman, Gentlemen of the National Tax Association: I regret that I am unable to discuss the able report given by Professor Lavery. I had an opportunity yesterday to read that report, and I want to say that I endorse everything that Professor Lavery has said in behalf of this committee. My paper will deal with the excess profits tax in general.

EXCESS PROFITS TAX

JOHN L. CONNOLLY

Secretary, Minnesota Mining and Manufacturing Co.

It has been said, "Experience is the best teacher," but apparently this rule does not hold good in the matter of taxation.

Those of us who had an opportunity to observe the operation of the excess profits tax acts which were in effect from January 1, 1917, to January 1, 1922, were greatly surprised by the ready acceptance of another excess profits tax law by the general public, which apparently had forgotten all of the evils of the original acts.

As many of you will recall, the acts that were in effect during the last war arbitrarily classified as *excess profit income* that part of the net income which was in excess of a specific exemption of $3,000 and plus either 7 percent or 9 percent of the invested capital. You will also recall that this particular provision caused a great many inequalities as well as endless litigation. Many cases were not de-

cided until 20 years after the tax returns were filed, and there may still be others in the process of settlement.

Most of the litigation involved the question of what constituted *invested capital.* It would seem that the one department which was charged with the enforcement of these prior acts should have been the first to admit that the single method of determining excess profits tax credit based on invested capital was not satisfactory when applied to industry generally; and that taxpayers should have other options or alternative methods to properly classify income as *excess profit income.* Yet we have the unusual situation of representatives of the Treasury Department appearing before the House Ways and Means Committe and the Senate Finance Committee in 1940 and 1941 and advocating that a percentage of invested capital should be the only method used in the computation of the excess profits tax credit.

Most students of taxation are agreed that an excess profits tax has no place in our permanent tax structure; that an excess profits tax law should be enacted only in the greatest emergency; and that no excess profits tax law can be enacted which would treat the great majority of taxpayers equitably—at least no plan which would provide equity for the majority has been proposed, nor has any been called to our attention.

At the present time we have an emergency, and no one can quarrel with the enactment of a fair and equitable excess profits tax law.

When the Revenue Act of 1940 was proposed by the President, we were given to understand that it was designed to prevent the creation of millionaires out of profits derived from defense—a most worthy objective.

There are many provisions in the Second Revenue act of 1940 which lead to the conclusion that when finally enacted it went far beyond the purpose stated by the President. The amendments adopted in 1941 clearly show that it is now primarily a revenue-raising measure.

In enacting a fair and equitable excess profits tax law, we must first define *excess profits.* We must set up some yardstick by which normal profits may be measured. One yardstick to measure normal profits is the average profit for prior years. What years should be taken into consideration? It should be some period immediately preceding the increase in business resulting from the defense program. Out of the many proposals submitted to the Congress of the United States, it was finally decided to take the average of the four years prior to the taxable year. For those taxpayers who did not enjoy any profits in prior years, or whose average profits during the base period were less than the percentage of their invested capital, the other method of measuring profits would be the invested capital method.

In the excess profits tax acts which were in effect during the first World War, we had only one method of measuring normal profits —by the percentage of invested capital. It is true that those acts contained a special provision for taxing personal service corporations and a relief provision permitting the commissioner of internal revenue to give relief to certain taxpayers in abnormal situations.

It is safe to say that anyone having experience in the operation of an excess profits tax law would agree that what constitutes a reasonable return on investment in one corporation would be wholly inadequate in another corporation.

The report of the hearings before the House Ways and Means Committee on the Revenue Act of 1941, on pages 1660 to 1671, records the testimony of Mr. Arthur C. Nielson, president of A. C. Nielson Company, Chicago, Illinois. It should be remembered that Mr. Nielson's testimony—some of which will be quoted for you—deals with profits in 1939, a year before the national defense program was originated. Mr. Nielson pointed out that return on invested capital varies widely by types of businesses. Of 142 companies engaged in trade, the average return on invested capital in 1939 was 11.2 percent; of 1,495 companies engaged in manufacturing, the average return on invested capital was 8.3 percent; of 351 financial companies, the average return on invested capital was 7.8 percent; of 137 public utilities companies, the average return on invested capital was 6.9 percent; of 100 service and construction companies, the average return on invested capital was 6.9 percent; of 127 mining and quarrying companies, the average return on invested capital was 4.8 percent; of 258 companies engaged in transportation, the average return on invested capital was .8 percent.

Mr. Nielson also pointed out that returns on invested capital varied widely by industries. The highest return on invested capital in 1939 was in the beverage industry. In 63 companies, the average return on invested capital was 21.5 percent; and the lowest return on invested capital was shown by the transportation industry—258 companies reporting an average return on invested capital of .8 percent.

Mr. Nielson submitted a schedule disclosing returns on invested capital by subdivisions of each industry. The schedule showed that during the year 1939, 29 companies engaged in the drug, soap, and allied trades had an average return on invested capital of 21.5 percent; 43 companies engaged in chemicals, etc., had an average return on invested capital of 12.7 percent; 15 companies engaged in paint and varnish had an average return on invested capital of 8.2 percent; 32 companies engaged in printing and publishing had an average return on invested capital of 7.1 percent; 74 companies engaged in selling paper products had an average return on invested capital of 5.6 percent; 8 companies engaged in making fertilizer had an average return on invested capital of 2.2 percent; and the

average return on invested capital for all of these businesses was 13.1 percent.

It is apparent that if *normal profits* are to be defined as 8 percent of invested capital plus a specific exemption, those companies engaged in the printing and publishing, paper products, fertilizer, and transportation fields earning the same rate of return in 1940 would be subject to no excess profits tax. On the other hand, those companies engaged in the beverages, drugs, soap, and chemicals businesses, deriving the same income in 1940, would be subject to a substantial excess profits tax on what appears to be truly normal profits.

In his testimony before the committees, Mr. Nielson also pointed out that returns vary widely on corporations within each industry; that the highest return in 1939 was 37.2 percent, and the lowest was 11.2 percent.

The foregoing figures, in our opinion, conclusively prove that a flat percentage of invested capital is not equitable even within the same types of industry, to say nothing about its inequity when applied to diverse industries. The record teaches further that an excess profits tax act is a complicated affair indeed.

While the Congress of the United States attempted to eliminate a number of the hardships by enacting a section dealing with abnormalities, the act is still deficient and should be amended. Yet it is a vast improvement on the former law in many respects. Specific instances might be cited, such as the two methods contained in the act for the computation of credit; that is, the excess profits tax credit is either a percentage of the invested capital or the average earnings for the base period, which is defined as the years 1936 to 1939, both inclusive.

The excess profits tax credit computed on average earnings under the present act remains static. The only time the credit changes in the future is that it increases as cash or property is paid in as capital and decreases if a distribution is made out of capital. Earnings retained and invested in the business do not increase the credit.

It should be amended whereby growing companies using the average earnings method would be entitled to increase their excess profits credits in future years. A corporation's business may be entirely different in 1941 or future years from what it was during the base period.

In the amendment to the Second Revenue Act of 1940, adopted by Congress in March, 1941, growing corporations were provided some relief, but there are no provisions for future normal growth. The mistaken opinion seems to be that all increases in profits during the years 1940, 1941, and future years are and will be due entirely to the defense program. It should be generally conceded that some part of the increase in profits is due to normal growth, and that growing corporations will be subject to a severe hardship unless

some additional credit is provided. It is our recommendation that growing corporations computing their excess profits tax credit on the average earnings method be permitted to increase this credit from year to year. We recommended before the House Ways and Means Committee and the Senate Finance Committee that a percentage of the retained earnings be allowed as an additional credit. There are probably other methods better than this which could be provided.

The excess profits tax act in effect during the first World War, in defining *invested capital,* excluded borrowed capital.

The Second Revenue Act of 1940, as passed by the House, included borrowed money as invested capital in graduated limitations at varying percentages—100, 66⅔, 33⅓. This provision was eliminated, and as finally passed, borrowed capital is permitted to the extent of 50 percent. One-half the interest paid on borrowed capital is excluded as a deduction in determining excess profits net income.

The act should be amended to exclude *all* interest on borrowed capital as a deduction and include *all* borrowed capital as invested capital. The exclusion of a part of the borrowed capital has a tendency to create methods of financing which must be called at least "peculiar." It holds out an inducement for companies to issue preferred stock to replace their bond issues, thereby increasing their invested capital by the total amount of property paid in for preferred stock, which would save them more in tax than they would lose by not having a deduction for interest paid on bonds outstanding.

The Second Revenue Act of 1940 provided for the deduction of the normal tax in determining excess profits net income. This provision was eliminated by the Revenue Act of 1941 so that now we have a situation where a corporation is paying an excess profits tax on that part of its income used to pay a 30 percent normal tax. Surely it cannot be successfully contended that a corporation derives excess profits income until after deduction of the normal income tax. The only recommendation for this change was the fact that the excess profits tax acts in effect during the first World War (which concededly were a failure and condemned by the public generally and the Congress of the United States) contained such a provision; and further, that unless this deduction was eliminated, the average earnings credit would have been reduced to 75 percent or eliminated entirely.

The act should be amended so as to permit a deduction for the normal tax. It is true that such provision was in effect during prior excess profits tax laws, but at that time we did not have the high normal tax which is in effect today. The prior revenue acts, in allocating the amount of income subject to the different rates, did so upon the basis of a certain percentage of the invested capital. The present act arbitrarily classifies the amounts subject to the

different rates upon the ratio by which the excess profits taxes exceed the credit, but solely upon dollar amounts; that, is the first $20,000 is subject to the lowest rate, and everything in excess of $500,000 is subject to the highest rate. This provision is responsible for a complicated provision known as the "highest bracket amount." The act should be amended so that the excess profits rates should apply upon the ratio between the excess profits and the credit.

The method for computing average daily invested capital requires a large number of computations and should be amended.

If revenue requirements prevent repeal of the declared value capital stock tax and the excess profits tax, there should be a provision for an annual declaration of capital stock value. In these times of priorities and scarcity of materials, a corporation should not be required to indulge in a guessing contest as to what the net income will be three years hence.

We are told that it will be necessary to have a new revenue act in 1942. Recently Secretary of the Treasury Morgenthau made a statement that it will be necessary to limit the profits of all corporations to a return of 6 percent of their invested capital. This theory was immediately given widespread publicity and comments were made by all newspapers and radio commentators. It was generally condemned by the press and the public, and, in the opinion of some brokers, had a depressing effect on the stock market. Senator George, Chairman of the Senate Finance Committee, issued a statement condemning this plan as did Chairman Doughton of the House Ways and Means Committe.

After the plan had been condemned, the Secretary then stated that this plan was not to be put into effect for the year 1941 but some date in the future. This 6 percent return on invested capital is no new theory in the Treasury Department. The Treasury Department, since the excess profits tax law was first considered in 1940, has consistently opposed the average earnings credit and had advocated, before House and Senate committees, a single credit based upon a percentage of invested capital.

The committee report just read to you quotes from a letter to the President, signed by Secretary Morgenthau, dated July 31, 1941, which states that, "the Treasury has consistently adhered to the position that the excess profits tax should apply to profits in excess of a reasonable return on invested capital."

In conclusion, for the purpose of emphasis I would like to summarize some of the points covered by me:

1. An excess profits tax has no place in our permanent tax structure.

2. An excess profits tax law should be enacted only during a period of grave emergency.

3. Only excess profits income should be taxed.

4. The present two methods for determining excess profits tax credit should be retained.

5. The schedule of graduated excess profits tax rates should be based on the ratio of the excess profits tax credit and not on the dollar amount of excess profits.

6. Growing corporations not engaged in direct defense contracts should be given additional credit so as to exclude from excess profits income such part of the income which may be attributed to normal growth.

7. The provision contained in the Second Revenue Act of 1940, permitting a deduction of the normal tax before computing excess profits tax, should be restored.

8. The act should be amended so as to include as invested capital 100 percent of borrowed capital; and the deduction for interest paid on borrowed capital should be eliminated.

9. The act should be amended so as to eliminate the provision requiring a large number of computations to be made to determine the average, daily invested capital.

10. The declared value capital stock tax and excess profits tax should be repealed; if this cannot be repealed because of revenue requirements, corporations should be permitted annual declarations of capital stock value.

CHAIRMAN COLE: Thank you, Mr. Connolly, for that fine paper.

As I look at the formal program this morning, I see that we have a majority of professors scheduled. I am reminded of the recent New England tax conference, when Professor Fred R. Fairchild, of Yale, a distinguished past president of this Association, conducted a symposium, the speakers upon which were mostly professors. He opened the symposium by telling a story about Booker T. Washington, who was to be introduced to a Southern audience by a Southerner. The presiding officer was somewhat embarrassed in the performance of this duty. He could not see his way to introduce the speaker as "Mr." Washington. Then he considered the possibility of introducing him as "Booker." But he thought that might not be quite in accordance with the dignity of the speaker, and he finally compromised by introducing him as "Professor" Washington.

We are fortunate this morning in having with us a representative of the Harvard Graduate School of Business Administration, to further discuss the report of the committee on the excess profits tax, and it gives me great pleasure at this time to introduce Mr. Dan T. Smith, professor of finance and taxation at the Harvard Graduate School of Business Administration.

DAN T. SMITH: Mr. Cole, Ladies and Gentlemen: I thought for a moment I might have a chance to tell one of my favorite tales on academic life. It is not altogether appropriate; but I was re-

minded of it by Mr. Cole's comment on the introduction of Booker T. Washington. There was some academic man testifying before one of the Congressional committees, constantly referred to as "Dr.", "Dr.", "Dr." And he got out of it very nicely, I always thought, when one of the members of the committee said, 'By the way, what sort of doctor are you, anyway?"

He very appropriately answered, "Oh, my daughter described it one time to one of her friends. I am the sort of doctor that don't do nobody any good."

I must say, Mr. Chairman, that my remarks will not be directed directly to the committee report. The matter of timing was such that it seemed best to prepare some specific remarks, without waiting to se the report, which was not available to me early enough.

Briefly, I can only say that I was very much impressed by the comprehensive coverage, the raising of problems, which seems to me to have been done in an admirable fashion, coverage that seemed excellent.

EXCESS PROFITS TAXATION

DAN T. SMITH

Harvard Graduate School of Business Administration

It is difficult to discuss any detailed aspects of excess profits taxation without first considering the continuing controversy over the relative merits of invested capital and prior earnings as bases for the tax. Though one cannot, perhaps, add much that is new to the discussion, the selection of an excess profits tax base is of such fundamental importance that repetition may be justified.

Common justice and national morale both require that in the present period of defense and war emergency no individuals or companies should gain unduly at the expense of the many. An excess profits tax based on prior average earnings, thereby taxing increases in profits, seems particularly suitable to meet this objective. If one could start from a period of reasonable prosperity for all industry, prior average earnings might be adequate as the sole base in excess profits taxation. But if one starts with distress conditions in some industries, there seems reason to give previously unprofitable concerns a chance to make a modest profit before applying excess profits taxation, just as poorly paid labor or individuals on home relief are given a chance to get normal wages in defense industries instead of being forced to work at their previous abnormally low income level.

Although the average earnings base seems peculiarly well adapted to reach unusually large earnings arising from the defense effort and has been used for this purpose in Great Britain and Canada, we have recurring statements in this country that in determining profits exempt from excess profits taxation, we should rely entirely

on a given percentage return on invested capital. It is obvious that for many companies this allowed return may be much smaller than the average earnings for a long prior period of time. Such profits are in no sense due to the defense efforts; they have come to be considered as normal returns and will have been capitalized in the security market and reflected in the prices paid by many of existing investors for their securities. Perhaps also these typical earnings will have been reflected in a company's own balance sheets through appraisal, reorganization, or mergers. It is, in fact, impossible on the basis of public records to determine the taxable invested capital. Thus for the great majority of investors, and even for management itself, the invested capital and hence the liability to excess profits taxation is determinable only after long and costly investigations through past accounting records. In such a situation, the sudden imposition of a substantial excess profits tax on all earnings in excess of some allowed normal return on invested capital cannot produce other than capriciously arbitrary results.

One can understand why a high rate of return on invested capital may be believed, at first thought, to have some peculiarly great tax-paying capacity. If such a tax were to be imposed from the beginning in a newly developing national economy, the justice, though not the wisdom of the legislation, might be unquestioned. If all commitments were made and ventures undertaken with foreknowledge of a tax rate which would vary with the rate of return on investment, there could be no claim of unfair discrimination. On the assumption that profits above some given "normal", say 8% to 10%, represent true economic surplus, they could be taxed away without serious restrictive effects, but the validity of this assumption is itself a point of fundamental debate in economic theory. Relatively high profits for some companies may be necessary to keep the low profit or deficit companies active.

Relatively high profits cannot be proven to be "surplus" elements by reference to the obvious fact that the companies now earning them would not liquidate if the profits were taxed away. Until we can be reasonably certain of the repercussions of such taxation upon industry in general, it seems unwise to embark upon an experimental program which might have disastrous consequences. And above all, we should never lose sight of the fact that our present excess profits tax is not being imposed as an original feature of a new economy; rather it is being imposed upon a long-established economy in which capital value has been developed largely on the basis of past, present, and probable future earnings. Excess profits taxation exclusively on an invested capital base should be judged on its merits as a proposed fundamental change in our tax structure; it should not be accepted as a necessary part of the defense financing program to which it is, in fact, really unrelated.

The problem of net income determination is of great importance in any excess profits tax, regardless of the definition of normal, allowable profits. The computation of income subject to excess profits tax involves three steps: first, the computation of net taxable income as determined for the normal corporate income tax; second, an adjustment of that income figure to eliminate certain unusual or non-recurring items; and third, the subtraction of the allowed normal profits not subject to excess profits taxation from the adjusted income figure to give the income subject to excess profits taxation. The first section of this paper dealt entirely with methods of fixing allowable profits not subject to excess profits taxation. The first and second steps, though less widely discussed, are equally important.

Various long-standing problems in the computation of taxable income have become more serious with the increasing normal tax rates and are acute under the excess profits tax. In a comparison of income as determined for tax purposes and for general public reports now nearing completion under the auspices of the Fiscal Policy Conference of the National Bureau of Economic Research, an attempt has been made to measure the extent of the discrepancies between taxable and business income and the reasons therefor. An investigation of several groups of companies reporting continuously from 1929-1936 indicates that the divergencies between taxable and business income may tend to balance out over the years rather than become cumulative. Large divergences in each year are themselves of great importance, however, because of different effective tax rates in different years. Without suggesting that either of the income figures represents an absolute or ultimate truth, it seems apparent that much of the taxpayers' feeling of discrimination and unfair treatment could and should be alleviated by liberal loss carryovers. But even these cannot properly compensate for rate variations or liability to different features of our tax system in different years.

The importance of taxing only real net income increases as rates increase: high tax rates are bearable only insofar as taxpayers do not believe they are being taxed on illusory profits. Especially at the present time, when temporary large profits are expected in many instances to be followed by large losses in the post-war adjustment, adequate recognition must be given to the danger of over-emphasizing the annual computation of income. Fortunately we are in a much better position now in this respect than we were a few years ago. The loss carryover has been re-established after having been unjustifiably removed during the depression when it was particularly needed to assure equitable treatment, and to avoid unreasonable burdens on companies in cyclical industries. Adequate loss carryovers serve in many respects as catch-alls to lessen the importance of many disputed aspects of income determination. But business is now concerned with present profits and prospective postwar losses; these are the two situations foreseeable at present and it is small

comfort to suggest that postwar losses may be applied, if the law is not changed again, against profits in the prosperity period following the postwar depression. It is vastly more to the point to try to relate war profits and postwar losses to each other.

In this respect, two other recent changes in the statutory definition of income are especially important in permitting a more reasonable measure of current profits. The permission to use last-in, first-out inventory accounting is particularly necessary in a period of rising prices. Any remaining administrative restrictions upon its wide application should be removed. If possible, some provision should be made for the nonrecognition of inventory profits by those companies for which last-in, first-out inventory accounting is not possible. Reserves for inventory price declines have not been permitted for tax purposes in the past, perhaps largely because they may be determined on rather arbitrary bases. In a period of rapidly rising prices, however, it might be well to consider whether use could not be made of selected price indexes to determine reasonable allowances for subsequent price declines in retailing and certain other fields. With present rates, we may actually have cases where inventory profits so increase taxable income that the cash inflow from operations will fall short of meeting tax obligations, even assuming no distribution of profits to stockholders. The fact that disposable cash does not correspond to taxable income may lead to acute problems under high excess profits taxation just as it did under the undistributed profits tax.

Another important recent change relating to income determination is the provision for rapid amortization of emergency defense plants and equipment. Estimates of the useful life of such property are so clearly contingent upon the duration of the war emergency that a failure to make allowance for unusually short service lives would be altogether inequitable. Unfortunately the expectations of Congress have not been realized in the past year because of certain ambiguities in the law leading to unreasonable restrictions in granting relief. It is to be hoped that recent proposed amendments will make special amortization truly available.

Other statutory provisions relating to income determination become increasingly important as tax rates increase; administrative policies, likewise, are of vital concern. With tax rates of 15% to 20% apparent inequalities may not be too severe, but with effective rates of 65% to 70%, the disallowance of losses or other deductions means, in effect, an additional government penalty equal to about two-thirds of the disallowed charge, and this may be fatal. Rulings which throw deductions into prior years barred by the statute of limitations or into periods when no effective tax benefit will be obtained will become increasingly burdensome. While proper safeguards are necessary to prevent taxpayers from juggling income

and deduction items to minimize taxes, it does not seem unreasonable for us to hope to achieve ultimately a system in which all real expense items and loss charges are taken into account taxwise, with only net income taxed over the years. The detailed changes necessary are not related solely to excess profits taxation, rather, excess profits taxation makes these fundamental improvements especially urgent.

The present statutory provisions for special adjustments to taxable income to determine income subject to excess profits tax are, on the whole, excellent. Treasury officials and the Congress acted wisely and equitably in removing certain abnormal and nonrecurrent items from the income computation both in the taxable year and in the prior years on which the average earnings base is calculated. Much of the complication in the law is due to these attempts to remove extraneous elements and make the law more nearly approximate net income derived from current operations. The exclusion of long-term gains and losses, income from retirement of bonds, and from recoveries of bad debts previously charged off, are all proper steps. The primary additional need is for a broader discretionary section intelligently and fairly administered, dealing with special situations not covered by the statute. The amendments of March, 1941, to the excess profits tax indicated, on the whole, a sympathetic appreciation by the Treasury and the Congress of the problems of small and growing companies.

The discussion of the proper treatment of borrowed capital under excess profits taxation has emphasized the need for a general reconsideration of the relation between corporate capital structures and the corporation income tax. The present allowance of half of borrowed capital in computing invested capital, with a corresponding disallowance of half of interest paid in computing income subject to taxation under the excess profits tax, is a reasonable compromise on a difficult problem. But present tax rates will raise acute situations in companies with large preferred stock issues outstanding and will make tax factors of primary importance in all future decisions on capital structures. Debt financing, instead of equity financing, has been encouraged by the deductibility of interest. When tax rates were 15% or less, the tax advantage, though appreciable, was not sufficiently great to be determining, except in the case of closely-held companies in which bonds or debentures could be issued to those who would otherwise have held preferred stock, with assurance that they would not embarrass the company during any period of financial stringency. In larger companies with public issues, tax considerations were likely to be significant only in situations where there was no basic preference for debt or preferred stock financing on the part of management, and such cases were not common. With normal tax rates of 30% or more, however, the tax advantage of borrowing may be decisive, since the contractual rate of interest is

in effect reduced by the percentage payable under the corporate normal tax and surtax.

Calculations are somewhat more complex under the excess profits tax because the full amount of any increase in equity capital is allowed in computing nontaxable profits, while only 50% of the increase on borrowed capital is so allowed. On the other hand, one-half of the interest paid is permitted as a deduction in computing income subject to the tax.

There are too many variables to permit a single tabular display of the combined effects of normal and excess profits taxation. In an appendix to this paper, an illustration is given to demonstrate some of the peculiarities arising from variations in the capital structure. Relations between the percentage rates of earnings, of payments on additional capital, and of allowable normal profits must be considered as well as the rates of normal and excess profits taxes. One must also consider whether the new financing is to come from existing stockholders, in which case aggregate return to all capital may be important, or from the general public, in which case return to existing common stockholders will be the chief concern. Two points seem worthy of especial emphasis. The first is that our tax structure operates to give unintended, and to some extent unrecognized, preferences to certain forms of capital structures. A complete study of these tax advantages and penalties would seem to be necessary to determine whether are are equitable or socially desirable. The second point is that the tax calculations are at once so complex and so important that a proper consideration of the tax implications can become a major problem of business management. Changes in rates, shifts between emphasis on normal and excess profits taxes and changes in the definition of invested capital or taxable income are of primary importance. Correct anticipations on these points are no more than lucky guesses; but unlucky guesses on tax changes may be more serious than unwise decisions on major aspects of a company's general policies. Decisions now made on financing, mergers, and reorganizations can have long-continuing effects on taxes paid. An assurance of stability in our corporation tax system is not possible; yet long-continued indecision on future tax policies at existing tax rates will make management exceedingly difficult, and divert some attention away from problems connected with efficient operations.

We have come a long way from our early income tax when the corporation and individual normal taxes were at the same rate, with dividends exempt from the individual normal tax. Equity income arising through corporate enterprise was taxed in the hands of the corporation when earned, and amounts distributed to stockholders were subjected to additional surtaxes based on the total income of the recipient. That part of total earnings going to borrowed capital

was taxed at the same normal rate in the hands of the interest recipients. With the subsequent divergences between individual normal and corporate tax rates and the subjection of dividends to the individual normal tax, we have developed a system completely lacking in internal consistency.

Are corporations to be considered as separate tax-paying entities or as agencies through which income attributable to individuals first appears? If we tax corporations separately, do we do so because we consider them as having their own tax-paying capacity or because we can thereby achieve higher overall taxation of "unearned income"? If we consider corporations as distinct entities with their own tax-paying capacity, should that capacity be measured by total equity income, total income to capital, or total entrepreneurial income, — three altogether different concepts? Justice aside, is it socially wise to impose, as we now do, particularly heavy tax burdens on equity income and especially the equity income in fluctuating, prince-or-pauper industries and on the risky investments in new enterprises? It is not intended to suggest any particular form of change; in fact, this is probably not the time for any fundamental overhauling of our tax structure. But the problems posed in the above question are made significant by the current high tax rates and would be made acute by a continuation of any form of excess profits taxation in the postwar period. Answers to them must be based upon an analysis of the entire field of corporate and individual income taxation.

Reasons have already been given for the belief that excess profits taxation should have no permanent place in our tax system. The present type of tax with its optional basis is a proper and reasonable temporary expedient during the defense emergency to secure revenue and improve national morale. Greater administrative discretion should be given to deal with peculiar cases where the tax is inequitably burdensome, and that discretion should be used to assure taxation only of unreasonably high profits arising directly or indirectly from the defense program. In the meantime we shall have interesting opportunities to study the effects of excess profits taxation on management policies with respect to expansion, wages, promotion and development work, and on the incentives of investors and management. But interesting though such studies are, it must never be forgotten that the present excess profits tax is related to a particular time and set of circumstances, and that any conclusions based on its immediate effects cannot be considered generally true. The patriotic and emotional appeal of the defense program, the prospect of price increases and government action and inaction relating thereto, and the shortage of men and things are all factors influencing the effects of this excess profits tax now,—and they all make any generalized conclusions based on current experience exceedingly dangerous.

APPENDIX

One illustration may serve to indicate the nature of the conditions confronting corporate management. For simplicity I have assumed a company with $1,000,000 of total assets and invested capital of the same amount represented by 10,000 shares, allowed normal earnings of $80,000, or 8% of invested capital, actual earnings of 10% or $100,000, an excess profits tax rate of 60%, and a combined normal and surtax rate of 30%. Total taxes, with the excess profits tax computed and deducted first, would be $38,400, with $61,600 available to capital, or $6.16 per share. If one assumes that the management sees an opportunity to use an additional $500,000 in the business to yield the same rate of return, or a total income before taxes and interest of $150,000, the following situation is presented. If the new money is raised by additional stock, total taxes will increase to $57,600, and total net return to capital to $92,400, or $6.16 per share. If the $500,000 is borrowed at 8%, total taxes drop to $45,600 with total return to capital, equity and borrowed, of $104,400, and $6.44 per share of stock. If the money is borrowed at 5%, total taxes increase to $53,250, and the return to total capital falls to $96,750, with $71,750 or $7.175 per share to equity capital. When preferred stock financing is compared to debt financing, in each case total excess profits tax is the same when the rate of payment is 8%, equal to the allowed normal rate, the entire advantage of debt financing coming from the difference in normal tax. It is notable that the return to existing stockholders is reduced in absolute amount by taxation, even though additional funds on which 10% is earned are secured at 8%. At the lower rate of payment, lower excess profits taxes payable in the case of stock financing because of higher invested capital, are more than offset by higher normal taxes, giving a net advantage to debt financing.

If the additional capital is to be provided by the existing stockholders, it clearly is advantageous to have the new securities issued as debt, at as high a coupon rate as possible. If the new money is to come from other parties, the aggregate net return to all capital is not of significance to the management or the existing common stockholders. The advantage to existing stockholders of borrowing at less than the rate that can be earned on the new money is drastically curtailed by taxation. Thus, if the $500,000 is borrowed at 8% while earning 10%, additional taxes absorb 72% of the $10,000 difference between the amount paid for and earned on the new capital. This percentage factor is the effective rate of a 60% excess profits tax and 30% normal tax. Of the apparent reduction in $15,000 in interest paid when the rate is reduced from 8% to 5% in the hypothetical case, $7,650, or slightly over 50%, is absorbed by increased taxes. Since one-half the interest paid is deductible, the reduction in interest of $15,000 increases income subject to excess profits tax by only $7,500, giving only $4,500 increase in excess profits tax.

Tax Effects of Various Methods of New Financing for Company A

(Rate of Earnings on Total Investment 10%—Allowed Normal Profit of 8%)

	A	*B* Additional $500,000 Stock	*C* $500,000 Bonds at 8%	*D* $500,000 Bonds at 5%	*E* $500,000 Preferred Stock at 8%	*F* $500,000 Preferred Stock at 5%
Total stock investment	$1,000,000	$1,500,000	$1,000,000	$1,000,000	$1,500,000	$1,500,000
Total bonds	—	—	500,000	500,000	—	—
Income before interest	100,000	150,000	150,000	150,000	150,000	150,000
Interest	—	—	40,000	25,000	—	—
Income *after interest*	100,000	150,000	110,000	125,000	150,000	150,000
Allowed normal profits	80,000	120,000	100,000	100,000	120,000	120,000
Income subject to excess *profits taxation*	20,000	30,000	30,000 *	37,500 *	30,000	30,000
Excess profits tax at 60%	12,000	18,000	18,000	22,500	18,000	18,000
Income after excess profits *tax and interest, subject to* normal tax	88,000	132,000	92,000	102,500	132,000	132,000
Normal tax at 30%	26,400	39,600	27,600	30,750	39,600	39,600
Income *available to* stockholders	61,600	92,400	64,400	71,750	92,400	92,400
Preferred stock dividends	—	—	—	—	40,000	25,000
Income *available to* common	61,600	92,400	64,400	71,750	52,400	67,400
Earnings per share	6.16	6.16	6.44	7.175	5.24	6.74
Total return to all capital	61,600	92,400	104,400	96,750	92,400	92,400
Total tax	38,400	57,600	45,600	53,250	57,600	57,600

* Income subject to excess profits tax equals income before interest less one-half of interest paid.

CHAIRMAN COLE: Thank you, Professor Smith, for that splendid contribution upon this subject.

We have now reached the point on the program where general discussion is in order; and, due to the fact that each of the speakers has strictly confined himself to the time limits set by the conference, we have a goodly period of time left in which a discussion may be had.

In opening the discussion, I see that we have in the audience another member of the committe on excess profits taxation, and I wonder if Mr. Frank E. Seidman would care to say something at this time.

FRANK E. SEIDMAN (Michigan): Mr. Chairman, Gentlemen of the Conference: I want to take this opportunity of making some comment especially on the factors brought out by the last two speakers, with whom I am afraid I shall have to basically disagree, in some respects.

I think one thing is clear—clear from our committee discussions, as well as clear from the discussions this morning—and that is that there is no simple solution to the excess profits tax problem. The difficulties in drawing a sound program for excess profits taxation result from the very complexities of modern corporate and public finance. Such terms as "invested capital," "normal profits," "excess profits," etc., may seem simple to define; but when the economists and the lawyers and the accountants have finished with them, they become as elusive as the concepts of higher theology.

These difficulties with the excess profits tax problem remind me somewhat of the story they tell—and I assume that is exempted from the time limit—of a man who was being sued in Florida for misrepresenting some sale of land he had made. The buyer was on the stand, and the buyer testified, among other things, that the seller told him that he could grow nuts on the land. When the seller got on the stand, he said, "Now, that is a little bit different from what I said. I didn't say that he could grow nuts on the land. I said he can 'go nuts' on the land."

I am afraid before out committee is through we will both "grow nuts" and "go nuts."

In the few minutes that are allotted to me I want to touch upon one or two general phases of our existing excess profits tax program; and, incidentally, comment on Secretary Morgenthau's recent proposal, which has already been mentioned. Any tax student examining the present excess profits tax law will readily conclude that it is full of major inequities and inequalities and defects, and that it is really nothing but the first World War system over again with some of the cobwebs brushed off.

As someone has recently said, if we limit taxation today to methods used in the first World war, we shall be making as great a mis-

take as it would be to send General Pershing's 1918 army, equipped as it then was, into the field against Hitler's 1941 mechanized army.

The major fault with the present act is that it literally writes profiteering into the law. This is accomplished by giving corporations an option to establish unusually high deductions in computing excess profits taxes. As Professor Lavery has pointed out in our preliminary report of the committee, the tax only begins after profits have passed 95 percent of the average earnings of four years, 1936 to 1939, or, in the alternative, until they have passed an 8 percent return on the first $5,000,000 of capital and a 7 percent return on capital in excess of $5,000,000. That is the 1941 act.

The way this formula works out, the stronger corporations become stronger, and the weaker ones weaker. Corporations that were fortunate enough to make large earnings in the pre-war emergency, or which are over-capitalized, can, under this formula, earn big profits without paying any excess profits taxes. This means that the railroads, the heavy industries, and many other "war babies," which are really getting the major benefit of the war orders, escape this tax almost completely.

Thus, for instance, United States Steel, with profits averaging in the preceding four years about $46,000,000, had a net in 1940 of $102,000,000, and did not pay one penny in excess profits taxes. Republic Steel, with a four-year average of $7,000,000, passed a net in 1940 of $21,000,000, and went excess profits tax-free. The railroads, whose profits have enormously increased as a result of the defense program, have to date escaped the excess profits tax almost completely.

On the other hand, many of the smaller companies that are not receiving war orders, and that are just getting on their feet, find that most of their earnings are considered excess in comparison with their poor showings in prior years, and are accordingly heavily taxed. This certainly is a case of taking it from the butter and giving it to the guns. It is an amazing situation, in view of the anti-war millionaire label that was attached to this program. A sound taxing program should, to my mind, tax excessive profits, as well as excess profits. In other words, normal excessive peacetime earnings should be subjected to excess profits taxation, apart from increased earnings. The fact that a corporation earned 20 or 30 or more percent on its invested capital in the past should not, during this emergency, give it the privilege of continuing at that rate. Such a taxing program entrenches those corporations which possess a monopoly position in our economy. Furthermore, a corporation that seldom earns a substantial rate on its capital should not be exempted from excess profits taxation if its earnings are increased, even though the increased earnings represent a low ratio to its invested capital.

Of course, exactly where to draw the line as to the rates of return to allow, or the fair earnings base to establish for exemption, is one

of the principal causes of trouble in excess profits taxation. Neither economics nor law offers much assistance in finding a concept of fair or normal profit. Any appeal to economics brings the reply that there is no economic normal of business profits. Legislators in framing an excess profits tax law must necessarily therefore assume an arbitrary normal, that may have little or no theoretical justification.

However, if an arbitrary normal is established, and it is then combined with a rate of taxation which is so high as to tax away almost everything beyond that normal, serious results might accrue. That is the basic objection to Secretary Morgenthau's recent proposal to tax 100 percent profits in excess of 6 percent on invested capital.

Secretary Morgenthau's proposal overlooks the fact that the main idea at present is to produce for defense as fast as possible, and that profit is the only real stimulant to production under a free economic system. Until the government takes over industry and management, there must be left sufficient incentive for voluntary economic activity. Otherwise, the whole machinery might stall. Our officials would therefore do well to guard against going off on such an extreme taxation tangent, and thus forget the main idea.

It should be pointed out that in England and in Canada, although actually at war, they have not resorted to a 100 percent tax; while nominally England levies a 100 percent excess profits tax rate, 20 percent of that amount collected is to be returned after the war. Thus that portion is in the form of forced savings, so that the English excess profits tax at the present time is really 80 percent, rather than 100 percent.

Personally, want to see excess profits taxed away at the highest possible rate consistent with maximum production. Apart from the social desirability of this objective, we just cannot afford to risk the public upheaval which would certainly accompany a bumper crop of defense millionaires. It is doubly important, in these days of strain and tension, that our tax policies be designed with the broad objective of preserving our economic system, and at the same time striking at the roots of abnormal and monopoly profits.

Thank you.

Chairman Cole: I am sure that we are indebted to Mr. Seidman for the points that he made on this important subject.

The meeting is now open for general discussion. I call your attention to the fact that this is an open forum, where you may say what you please to say, if you like. If you like a tax, you may say so; if you don't like it, you may say so. The saying, " I wholly disapprove of what you say, and defend to the death your right to say it," has application here.

The meeting is now open for discussion. The chair will be pleased to recognize anyone who wishes to talk. I know there are persons in the audience who are brimful of this subject of excess profits. Perhaps they want to content themselves with cussing it, and prefer not to dis-cuss it. Does anyone wish to be heard?

MR. LAVERY: Mr. Chairman, I asked at the end of the committee's report that its life be extended for another year, and I understand that the proper way to present that is to offer a resolution to that effect, which can be presented to the Resolutions Committee. I offer a resolution, therefore, that the life of the Committee on Excess Profits Tax be extended for another year, and I will write that out and see that it gets to the Resolutions Committee, if that is in order.

PHILIP ZOERCHER (Indiana): I second the motion.

CHAIRMAN COLE: You have heard Professor Lavery's resolution to the effect that the Committee on Excess Profits Tax be continued for another year, which he will write out and present to the Resolutions Committee. In accordance with the rules governing this conference, the resolution will be accepted and referred to the Committee on Resolutions, without debate.

Does anyone else care to offer a resolution? Does anyone wish to be heard?

PAUL J. WIMSEY (Illinois): I would like to ask Mr. Lavery if his committee gave any consideration to the effect on the invested capital feature of 112-G-1 as it concerns reorganized railroads.

MR. LAVERY: I can answer that by saying that, generally speaking, we didn't consider any particular section of the excess profits tax with reference to its application to particular cases. We had two meetings of the committee, one on June 2nd this year, and one on September 2nd, in New York City, and the committee, as you probably noticed, is rather widely scattered geographically, and at each meeting only six members appeared; nor were they the same six at the two meetings. So that our discussions were, I should say, in the most general terms, and we didn't consider any particular section of the statute. In fact, we thought that our problem—our first problem—was to decide the general questions that are mentioned in the report; that is, to discuss those general questions, and to reach a conclusion, if possible, as to whether, under any circumstances, an excess profits tax was desirable, or whether it was imperative, and the only real conclusion so far that we have come to—and that is a very tentative one—is that in a time of threatened war, some form of excess profits tax is desirable; but what form that tax should take, what its reach should be, how it should distinguish between one business and another, if it should,—those are questions that we still have to consider.

J. A. Boulay (Minnesota): I am inclined to agree with Mr. Seidman that during a period of this kind, while the emergency remains as great as it is now, or appears to be, an excess profits tax should be based on the theory or the principle that income which is beyond some sort of normal return, whether it be greater than earned in prior years or not, should be taxed; and I am not so much here to make a recommendation as to ask a question. Unfortunately, I wasn't there in time to listen to the committee's report. I wonder if this committee, or any other committee of the Association has devised any plan for applying the principle that I have just referred to? It seems to me that in view of the extreme difficulties involved, this body might render a real service to Congress if it could devise some plan which would be economically sound and practical.

Mr. Lavery: May I say another word there, Mr. Cole?

Chairman Cole: Certainly, Professor Lavery.

Mr. Lavery: We have had that question, of course, before us; but we have not formulated any answer to it at the present time. Certainly, the view of the Congress is pretty clear, as represented by the enactment of the 1941 act; the position of Congress is that apparently a good many corporations are entitled, as one of the committee members said, to "a little gravy," before the excess profits tax should be applied; that is to say, they should be allowed to fatten up a little now, after a good many lean years, before being subject to any excess profits taxation.

I think there is a very important and serious question as to whether, in a time of threatened or perhaps actual war, a corporation should be allowed to make any profit. That is a question we had before us. But we haven't any answer to that question so far. Of course, Secretary Morgenthau's proposal a few days or a week ago seemed to me to mean that, in time of war, all corporations would be put in what we normally regard as the position of public utilities, so that their rate of return will be definitely limited.

I think it goes back to this problem: how serious is the emergency we are facing? We are not going to be allowed, as I said in my report, if there is an actual invasion of this country with a hundred divisions of motorized troops, to sit here in St. Paul and talk about whether we will use one method or another. If it comes to that, the consideration even of profits will have to be postponed. But are we there now? Well, the committee will consider that. All I can say is we will consider that when we resume our deliberations after this meeting is over, if our life is extended.

I don't want to give you the impression that we have any position on it at all. At the present time, all we can say is that we are aware that there is that problem among any number of other problems, some of which are referred to in the report.

R. C. VAUGHN (North Carolina): I would like to ask some member of the committee, or Professor Roy Blough, if he is in the audience, whether there is at the present time any possibility of adding into the excess profits tax the partnership proposition that was in the old 1917 law?

CHAIRMAN COLE: The inquiry is whether there is any suggestion at the present time to include in the excess profits tax act the provisions relating to partnerships which were contained in the excess profits tax act in effect during the previous war. Can anyone answer that? I think Mr. Blough is not present.

ROY BLOUGH (District of Columbia): Yes, I am here.

I am not a prophet, nor the son of a prophet, and that is the reason I didn't get up automatically. Who knows what is going to happen? About all I can say is that I haven't heard any suggestion to that effect in recent months. Aside from that, I certainly am in no position to forecast.

CHAIRMAN COLE: I think that answers the inquiry, and we are going to restrain ourselves this morning, and refrain from taking a vote on the question of whether we do or do not agree with Secretary Morgenthau's suggestion of a 6 percent limitation.

W. R. BRADLEY (South Carolina): Of course, we all know that the burden ought to be equally distributed as nearly as possible, and I wonder whether or not it were not better if Congress would impose an excess profits tax, but make it a very reasonable excess profits tax, and impose in addition to it a sales tax, because the United States Government can enforce a sales tax much more beneficially than the states can. They can stop commodities coming into the United States, or they can stop commodities from going out of the United States. It would be easily enforceable, because the retailer wouldn't have to make the returns. He could get the tax at the source.

I would like to ask some of these gentlemen here who are familiar with this question whether or not the Congress has considered that: and, if they have considered it and discarded the idea, what was the reason why they discarded that idea? I would like somebody to tell me just why they have discarded that idea, if they have considered it.

CHAIRMAN COLE: Can anyone enlighten us on that subject? I am afraid there is no one qualified to speak in answer to that question.

E. H. PLANK (Texas): I would like to ask Mr. Seidman if he has any specific proposal to correct this fundamental difficulty that he mentioned in connection with the present law, or if he has any

ideas along that line? I would be very much interested to hear about that.

CHAIRMAN COLE: We will be glad to hear from Mr. Seidman.

MR. SEIDMAN: I don't know that I have any cure-all. I started by saying that the problem presents tremendous difficulties, and you can't solve them to the extent of meting out absolute equity. No tax does. But, in general, I think the Treasury program proposed by Assistant Secretary Sullivan, which permits an exemption on invested capital within limits, maximum and minimum limits, based upon the experience of the specific taxpayer, during a sufficiently extended period of time to indicate approximate taxpaying ability or earning ability—in other words, as you remember, Secretary Sullivan's suggestion was that invested capital be taken as the base for exemption, but that corporations be permitted to get an invested capital exemption based upon the experience of the specific corporation during the years 1936 to 1939, except that no corporattion shall be entitled to an exception of less than 4 percent or more than 10 percent on its invested capital.

We had something of that kind in the first World War experience—a fluctuating rate on invested capital, based upon the specific history of the specific corporation, but with minimum and maximum limits, considering that any corporation that earns more than the maximum is earning during this emergency excessive profits, and insofar as I am concerned, those excessive profits, as well as excess profits as growing out of the defense program, should be severely taxed, when all of the other departments of our population are being severely taxed in terms of service and so forth to the nation.

CHAIRMAN COLE: Thank you, Mr. Seidman.

HARVEY L. LUTZ (New Jersey): A gentleman asked a simple question a while ago, and I don't want to let the answer go by default. I assumed that everybody knew the answer, and therefore it was not deemed necessary to put it in the record. He asked why Congress was not considering such taxes as the sales tax. The answer is very simple. There are too many voters that would be affected by that kind of tax.

CHAIRMAN COLE: Well, that is direct and to the point.
Now, who else wishes to be heard?

ROBERT C. BROWN (Indiana): Mr. Chairman, there was one point raised by Mr. Connolly that I think deserves a little more emphasis than was given, and that is the theory that the excess profits tax ought not to be on a flat dollar figure, but a percentage figure. I think there is a good deal in that, and that particularly for the reason given before the enactment of this act to cut down war millionaires. I am personally one of those old-fashioned people who particularly

irritate Mr. Eccles, who feels that taxation is for the purpose of raising government revenue. But nevertheless, I am willing to accept that proposition for the excess profits tax, and I would point out that putting it on a dollar basis means a heavier tax on big corporations, the stock in which is apt to be rather widely held, and it makes it much easier on smaller corporations, which may make pretty big profits in comparison with their investments and so on, and even more in comparison with the broadness of their stock holdings.

If a corporation is held by two stockholders, the chances of making those two millionaires are pretty great, on comparatively small corporate earnings—much greater than the chance of making millionaires out of stockholders of United States Steel, even on very large earnings.

CHAIRMAN COLE: Now we are going places.

MICHAEL D. BACHRACH (Pennsylvania): There has been a great deal said about the complexity of the excess profits tax, and the fact that in any event it is bound to be inquitable when applied to so many different types of corporations. I am wondering why no one has ever suggested—or maybe they have, but it has not been considered—that one way to achieve fairness would be to have a provision in the law which says that the ultimate amount of tax should not exceed some fixed percentage of the net income, such as 50 percent, or 60 percent, because, as I understand it from public accountancy practice, business men realize the necessity for contributing heavily to the national defense program, but they seem to believe there should be some maximum limit on the earnings which the government, in any event, will take.

By having such a fixed maximum limit, you avoid a situation where a corporation with no base year earnings or very little, and with an abnormally low invested capital, will not have most of its present earnings taken away from them, and you also solve the question that has been suggested, that reserves should be allowed, to provide for the years when losses will inevitably follow these high-earnings years.

If someone would comment on that point, as to why there is not a fixed maximum, I think it would be interesting.

CHIRMAN COLE: That is a good suggestion. Of course, there is no maximum fixed by any law of Congress. I might suggest that there is a maximum fixed by the law of economics, shall we say, of 100 percent, but I think the speaker had something else in mind.

Does anyone care to develop that thought?

MR. SEIDMAN: Mr. Chairman, I might mention that in the first World War law there was such a provision. A maximum of 30 percent on the first $50,000 of earnings, and 65 percent,—I don't remember now—on the balance. I think the maximum now is pro-

vided by the maximum rate itself. In other words, corporations can't pay more than—as far as excess profits taxes are concerned—65 percent. That is the maximum rate now. But when the rates get graduated up to where Mr. Secretary Morgenthau has in mind, possibly at that time they will be considered a maximum.

Mr. Zoercher: Mr. Chairman, with reference to what my good friend Dr. Lutz said about a sales tax, the reason Indiana didn't adopt a sales tax, but took the gross income tax, was on this theory: here is a man who has six children. His income is $1,100 a year. Here is another man who has an income of $15,000, and has only one child. If you are going to have a sales tax, the man who has the six children will pay six times as much as the one who has only one child, when, on the other hand, the gross income tax only taxed the man who had an income of $1,100 on $100, because they allowed him a deduction of $1,000; the man who had an income of $15,000 paid on $14,000.

Now, I will leave it to you. It wasn't on account of the number of voters, no; but on the fairness of the distribution that it didn't put the tax on the poor man who always had the most children.

Chairman Cole: I think the only answer to Mr. Zoercher is that the person who has six children is immensely more wealthy than the person who has only one!

Martin Saxe (New York): I only want to rise to observe that Mr. Zoercher as usual takes the wind out of the "sales."

Chairman Cole: We else has a contribution? We are going along nicely. Let's not break the continuity.

I might say, on behalf of the committee; although I haven't consulted the chairman, I am authorized to say this—that there is a great deal of interest in this topic, as evidenced by the attendance here this morning. We appreciate the fact that all people are not public speakers, and perhaps some feel some embarrassment about talking in public. At the same time, they may have some very excellent ideas. I am sure that the chairman would be very glad to have anyone who has any thought on the matter of excess profits taxation to communicate with him.

Is that right, Professor?

Mr. Lavery: I would like to say a word about the committee. I intended to start off my remarks with—and after I got up there I decided not to, and now I have decided that I will say it—telling you a little about how this thing started.

Last September in New York Bill Sutherland—I suppose most of you know him; he is a lawyer from Atlanta, and I think one of the ablest lawyers in the South—asked me if I would have breakfast with him. I am a rather naive and unsuspecting sort of cuss, and

I thought there was a chance to have breakfast with a delightful companion, so I accepted. When I got down there, he said, "I want you to help us draft a resolution calling for the appointment of an excess profits tax committee." Well, I fell for that and helped him draft it, and we presented it to the Resolutions Committee, and they presented it to the conference, and it was adopted.

That I thought was the end of it. I had even fortgotten all about it. On the night of January 10, 1941, I got home from Columbus, and there was a long telegram waiting for me there from Mr. Maxwell, and he said this would be one of the most lively topics at this Association meeting, and, after consulting with his friends—and so on and so forth—he would like to know if I would accept the chairmanship of the Excess Profits Tax Committee. He named off the members he proposed to appoint, and I think, in due fairness to the committee, which was composed of twelve members, I must say it is an all-American committee—that is, the eleven men on it are all-American, and the mascot is the chairman.

I was completely dismayed when I got this telegram, and I immediately telephoned to Sutherland in Atlanta, and finally located him in bed in Washington. He got up very sleepily and said, "Why Tom, you go ahead and accept that chairmanship. We will all help you, and, after all, I think we can get Haig to take it over, if you will just start it off." He said, "You take it, and we will get Haig to do it, because he is just full of this stuff, and it will be no trouble for him. You start it off, and we will see that he does it."

Well, Mr. Maxwell sent out the invitations to the members of the committee. The acceptances gradually came in. We got off to a flying start, I thought, when Mr. Magill sent me a copy of his letter to Mr. Maxwell, in which he had written in red on the bottom, "Tom, you write the report and I will sign it."

Dr. Haig wrote to Mr. Maxwell and said, "I am glad to accept the appointment to the committee." He wrote to me and said, "I want to assure you how delighted I am to be allowed to serve under your direction," and so on—but he admonished me in the last paragraph with this: "Speaking as the chairman of a recent committee of the National Tax Association on the Taxation of Corporate Profits, I can only say that I hope the good God will have mercy on your soul!"

That sounded rather ominous to me, so I said nothing about this idea that we were going to call the signals and shift the ball-carrying to Haig. But somebody let that out, because I got a letter from him about two weeks later. He was down in Florida basking in the sunshine there at Winter Park, and he said, "Dear Lavery: I have heard rumors to the effect that as soon as this committee gets under way, you are planning to shift the chairmanship of it over to me. If that is true, it only goes to show you how completely

wrong a good man can occasionally be. Brother, you are stuck. With kindest regards, I am, Faithfully yours, Robert M. Haig."

Well, I will leave it to your verdict to say whether I am stuck or not. If I am not, I don't know when I shall be!

MR. LUTZ: Mr. Chairman, I merely rise to protest that, in the first place, there is no wind taken out of my sails, and no skin off my back, by this interchange with Mr. Zoercher. I have long admired the Indiana gross income tax. In fact, I have been one of the original exponents of the federal tax on gross income collected at the source. But I also want to point out that his friend with six children represented seven potential voters, and that was another reason why Indiana did not introduce the sales tax.

CHAIRMAN COLE: We all become enlightened as we go along. Up to the present moment I had never presumed that there was any relationship whatsoever between taxation and politics.

Does anyone else wish to say anything?

If not, and the subject is exhausted—

MR. LAVERY: I object to that, Mr. Chairman. It isn't exhausted.

CHAIRMAN COLE: The chairman of the committee is not the subject. I know he is not exhausted!

We will stand adjourned.

(The meeting thereupon adjourned, at 11:20 o'clock.)

FIFTEENTH SESSION

WEDNESDAY, OCTOBER 15, 9:00 A. M.

Ballroom, Lowry Hotel

ROUND TABLE CONFERENCE

J. Lambert Gibson, presiding.

(Presented below are the full texts of all the papers delivered by the participants on this program, exclusive of the extemporaneous remarks of the chairman.—EDITOR)

THE TAXATION OF THE MINING INDUSTRY IN MINNESOTA

E. H. COMSTOCK

University of Minnesota School of Mines

It is a constitutional requirement that all property within the State of Minnesota shall be taxed except that which is by the constitution specifically exempted. It is a statutory requirement that all property shall be assessed at "its true and full value in money." By implication the term "true and full value" means "the usual selling price, at the time of assessment, being the price that could be obtained therefor at private sale, and not at forced or auction sale." In particular, the statute provides as follows: "In valuing real property upon which there is a mine or quarry, the same shall be valued at such price as such property, including the mine or quarry, would sell for at a fair, voluntary sale for cash." This state has avoided reference to those two mythical personages, "the willing buyer and willing seller," but it cannot be said that the difficulties incident to valuation have been lessened by the substitution for them of a "voluntary sale for cash and not at forced or auction sale."

This is particularly true in the case of iron mines. The first shipment of iron ore from the state came from the Vermilion Range and was made in 1884. In 1889, before merchantable ore was discovered on the Mesabi Range, the legislature had passed a mineral lease law providing for leases on state lands to explore for minerals and for the payment of royalties on all ore shipped. This law also provided that the Land Commissioner of the State Land Office should endorse contracts or patents for the sale of state lands in

certain counties where iron ore had been discovered, with the words, "All mineral rights reserved to the state." Later this provision was extended to apply to all state lands wherever situated. With the opening up of the Mesabi Range, many of the private interests owning lands in this area, following the example set by the state, refused to sell, and leased their lands under a royalty contract. In some cases the owners gave up their own interests to the mining companies in exchange for stock, but this was the exception rather than the rule. As a result, sales of lands containing iron ore have been infrequent and the statutory requirement for assessment difficult to fulfill on that account. Those faced with the necessity of determining the "full and true value" of a mining property without a sale, forced or otherwise, must of necessity resort to other methods.

What is value? A purely relative term so well brought out by Russell Conwell in his "Acres of Diamonds" a half-century ago, acres of diamonds, worthless to the owner dying of hunger and thirst in their midst. What is the value of a suit of clothes to a merchant and why? One judge has said that a suit is worth twenty-five dollars to him because he hopes to make a profit of fifteen dollars from its sale. An intrinsically better suit, made of finer material with superior workmanship, might be worth far less if his customers were not interested at the price asked. The suit for which he paid twenty-five dollars is worth less than this amount if it does not move the first season, by the interest on his investment.

The value of a mining property to a mining company, in other words, "the price as such property, including the mine or quarry, would sell for at a fair voluntary sale for cash" is obtained by the use of exactly the same principles. A mining company interested in the purchase of such a property and employing a competent staff of engineers would estimate the available ore supply and the amount of ore which could be disposed of each year. Dividing the first by the second, they would obtain the "life of the property." They would then estimate the future price of the product of the mine and the cost of production and marketing, due allowance being made for the return of the capital necessary for plant and equipment together with interest during the life of the property; taxes; and any other items which would decrease the net income. The difference between these two items computed in terms of the proper unit, ton of ore, pound of copper, or whatever the product might be, multiplied by the expected yearly production expressed in the same units would give them the estimated yearly net income. This together with the expected life of the property and a method of and rate of discount would enable them to find the "present worth" or cash price which they could afford to pay. The payment of an amount in excess of this figure would be economically unsound unless justified by other considerations. Some years ago in our own state a mine was purchased at a price exceeding this estimated

value. The company gained in the long run as their lease was non-cancellable and after the purchase they could shut down the mine and ship ore from another source without the payment of excessive minimum royalties to the fee owners. This constituted a "forced purchase" and no more reflected the true value than had it been a forced sale at less than its true worth.

The method described above is essentially that used by the Department of Taxation of the State of Minnesota in estimating the value of a mine for purposes of taxation. Summarizing, the steps involved are as follows:—

(1) Estimate of the available ore supply.

(2) Estimate of the annual ore production, which with (1) makes it possible to determine the life of the property.

(3) Estimate of the selling price of the product in terms of the proper unit.

(4) Estimate of the unit cost of production which with (3) makes it possible to determine the profit per unit. This figure with the annual production determines the profit per year.

(5) Computation of the present value of the property by means of a properly selected formula and with the rate or rates of interest commensurate with the hazards involved.

Briefly the application of these five steps to the valuation of an ore body as practiced in this state is as follows:

(1) There are three types of ore deposits in Minnesota. On the Mesabi range the ore bodies are flat, trough-shaped, comparatively large, and relatively shallow. Drilling costs are not high and the iron-bearing formation has been thoroughly explored. The common unit for exploration is a forty-acre tract. Holes are drilled and when ore is reached, samples are taken every five feet until the taconite or quartzite, which underlies the ore body, is reached. These samples are chemically analyzed and their iron, phosphorus, silica, manganese, alumina, and moisture content determined. The surface of the property being drilled is usually laid off into 100-foot squares and drill-holes put down every 100, 200, or 300 feet depending on circumstances. All of the exploration data obtained by drilling is plotted on an "exploration sheet" which shows the location of the holes and the chemical analysis of each five-foot sample together with the location of the sample in the hole. These exploration sheets are furnished to the Department of Taxation together with the estimates of the tonnages of various grades of ore as determined by the mining companies.

Whenever the Department desires to have these estimates checked the exploration sheets together with any other pertinent information is sent to the School of Mines and Metallurgy where a separate estimate is made by designated members of the staff. The procedure is as follows:

Cross-sections of the ore body are made from the drill-hole data showing the bands of ore of the various grades as determined by the chemical analyses. The number of such cross-sections is dependent on the amount of drilling and the extent of the ore body.

The greatest of judgment is necessary in preparing these cross-sections, as the class into which the ore of a given analysis is to be finally placed is dependent on many factors. A knowledge of various mining methods, the practices used in the preparation of cargoes for shipments to the lower lake ports and a knowledge of blast furnace practice are required. To these things must be added, engineering skill of a high order, freedom from partiality and absolute fairness to all interests concerned. This enables one estimating the property to break up the various grades of ore into geometric blocks, the volumes of which can be easily obtained. The sum of the volumes of all the blocks of a given grade of ore divided by the proper factor (cubic feet per ton) gives the tonnage of that particular grade. A report is then prepared for the Department of Taxation showing the tonnage of the various grades of ore together with any additional information which will be of assistance in determining the valuation of the deposit.

This checking of estimates has been done by the School of Mines and Metallurgy since 1909, when it was felt that the school could render a valuable service to the state free from any possible criticism of political expediency or bias. The sole concern of the school is to make their estimates as nearly 100 per cent accurate as engineering practice will permit.

On the Vermilion Range the ore bodies are steeply inclined and the horizontal sections are relatively small in area. Much of the iron formation is very hard, tough jasper very difficult to penetrate with a drill. Furthermore, many of the ore bodies are relatively deep, in some mines from 1,500 to 2,000 feet instead of extending but about 400 feet below the glacial drift as in the case of the Mesabi Range. For these reasons it is practically impossible to determine their extent by drilling from the surface. Here the exploration must be by shaft-sinking and running drifts until the ore body is encountered. When this occurs and additional drifts are run so as to expose the ore on all sides, an estimate of its extent at that elevation can be made. When an opening is made at a lower elevation and the outlines of the body determined at this level the volume of ore between the two can be estimated by assuming that it is continuous in the intervening space. This assumption may or may not be true. Theoretically it would be possible to go by successive steps to the bottom of the ore body and thus obtain the information necessary to completely outline its extent. This, however, would be an expensive and unnecessary procedure, except for the possible purpose of satisfying the owners' curiosity. Those

mines operated under the direction of a corps of competent engineers and geologists only open up sufficient ore to maintain the output of the mine and defer exploration until they obtain enough information from their mining operations to aid them in searching for additional ore. This is the practice in the mining districts in most of the world, not alone in Minnesota. It is recognized by taxing authorities in most states where ad valorem taxes are based on the value of the ore body. The common custom is to assume that the ore extends vertically one hundred feet deeper than its showing on the bottom level of the mine unless the company can prove by adequate exploration data that this is not the case. This is the practice in this state.

On the Cuyuna Range the ore bodies are in the form of steeply inclined narrow lenses. The rock walls surrounding them are mainly schist or slate. Surface drilling is not so difficult as on the Vermilion Range. An added advantage is that the associated slates carry sufficient magnetite to attract the magnetic needle. As a result, the neighborhood of the localities where the presence of these slates is indicated by the dip needle, furnish likely places to drill for exploratory purposes. The procedure of ore estimating for bodies on this range is essentially the same as that used for the Mesabi.

(2) The annual production is taken as the average production for the past five years. In the case of the Mesabi Range, it is considered that every ton of ore is potentially competitive with every other ton. The annual shipments are limited by the carrying capacity of the vessels transporting the ore to the lower Lake ports and also to the capacities of the furnaces using Minnesota ores. These two items furnish the ceiling, not the production possibilities of the mines themselves. For these reasons the "range life" is used in all calculations and is obtained by dividing the total Mesabi Range tonnage by the average shipments for a term not less than the past five years. Certain low-grade iron-bearing material which appears on the tax rolls at a low valuation but is not being utilized at the present time is deducted from the total tonnage as not being competitive. This results in a lowered Range life.

(3) The selling price in dollars per ton is taken to be the average of the so-called Lake Erie price for the preceding five years.

The value of any given ore to a particular furnace depends not alone upon the iron content, but also upon the structure of the ore; the phosphorus content; the percentages of manganese, silica, alumina and sulphur in the ore; the cost of transportation from Lake Erie ports to the plant; the cost of coke and limestone at the plant; and the amount and kind of impurities in the coke and limestone. It is possible then for a particular ore which would be useless to one furnace to be an ideal ore for another furnace operating under different conditions. To the first furnace this ore would have no value while to the second furnace its value might be high. The

value of an ore to a particular furnace determines what price that furnace is willing to pay for the ore.

There being no simple standard by which the price of iron ore can be established, there has grown up through the years the trade practice of recognizing a "Lake Erie base price." Originally, one of the independent iron ore producers, having made a sale of a substantial tonnage on the open market at a price which it considered satisfactory, would announce the sales price, and that announced price would be recognized by the industry as establishing the base price for that year. Other independents selling iron ore would sell at that price, or if they could not obtain it, at discounts under it. Since other sale prices were seldom announced, the extent to which the practice of discounting the base price existed in earlier years is unknown.

During the depression, the base price was apparently pegged at 1929 levels, notwithstanding very sharp drops in the selling price of scrap iron and steel, pig iron and all other forms of iron and steel products.

The use of the Lake Erie price by the taxing authorities has been the source of argument pro and con in Minnesota for the past ten years. Much of the argument arises from the pegging during depression years. Much of it arises from the fact that until the last few years there was little or no available information on actual sales prices, and from the fact that a comparatively small portion of the iron ore produced is sold on the open market. In recent years the Tax Commission at various hearings has accumulated considerable information as to the actual price at which open market sales, other than the one establishing the base price, have been made.

At the present time, the Lake Erie price has weight as, in effect, a list of catalogue price at which one or more of the leading independents are willing to sell substantial quantities of iron ore. The use of this price by the Department of Taxation in computing the value of iron ore properties and in computing the occupation tax results in higher valuations for tax purposes than would be the case if the actual selling price were used.

To be used in the valuation of a mine the Lake Erie price is computed for the grades of ore in the mine as determined by analysis.

(4) The cost of production per ton of ore is divided into the following eleven items:

1. Mining
2. Beneficiation (where practiced)
3. Miscellaneous
4. Development (Future)
5. Plant (Future)
6. Rail and Lake Freight and Marine Insurance

7. Marketing Expense
8. Social Security Taxes
9. Ad Valorem Realty Tax for Operating Period
10. Occupation Tax
11. Federal Income Tax.

The unit costs for each of the items above for all types of mining are known, having been determined from experience in the field as well as from annual occupation tax reports upon each active property received from the operating companies.

(5) The Bureau of Internal Revenue of the federal government approves the method of valuation on the basis of the present value of estimated future income in the event that the value of natural resources cannot be determined by more accurate means. The courts of many states have ruled this method as acceptable in their respective states. Some years ago it was applied in a novel manner in Illinois. A limestone quarry in the vicinity of Chicago had been worked out, after which the property was carried on the tax rolls at a nominal figure. In a certain year the valuation was greatly increased and the owners demanded an explanation. The assessor stated that the quarry was being used as a dump and that a fixed charge was made per load. He had estimated the number of loads dumped per year and the corresponding volume of material deposited, had figured the number of years which at that rate would be required to fill the quarry, and had computed the present worth of the expected future income to arrive at the value of the hole in the ground as a city dump. This was sustained in both the district and supreme courts of that state.

In Minnesota in *State* v. *Oliver Iron Mining Company*, 198 Minn. 385, the district court found as follows:

> "The formula to which we have referred is known as the Hoskold formula. It is now accepted by both the state and the defendants as the best available basis for valuing ore deposits. It is used by other State Tax Commissions in making valuations of ore deposits, and is used by mining men in buying and selling ore properties. It is approved by the courts. *Newport Mining Company* v. *City of Ironwood*, 185 Mich. 668; *State Tax Commission* v. *Magna Copper Company*, 15 Pac. 2nd 961. But its use is that of a guide, its results to be modified according to the judgment of parties interested as to the accuracy of the factors used in applying it."

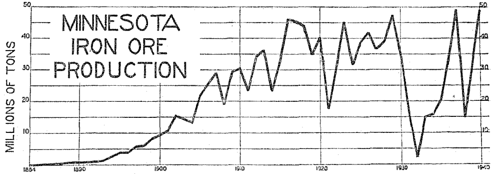
Numerous formulae have been developed for finding the present value of future income. Some use one rate of interest, some two rates and a few even use three. The variations are due to different methods of handling some of the factors involved and the relative importance of the various factors in the minds of the proponents.

A detailed study of the available formulae would be both interesting and profitable but is not within the scope of this paper.

In the Hoskold formula two rates of interest are involved, (1) a speculative rate of interest on the capital invested proportional to the original risks assumed and (2) a safe rate of interest at which, theoretically at least, the return of capital may be placed so that at the end of the life of the mine the sum of yearly capital returns plus the accumulated interest will equal the present value.

The district court used seven and four percent for the two rates, which use was affirmed by the Supreme Court. The use of seven percent for the risk rate was certainly liberal to the taxing authorities. Most engineers agree that ten percent should be a minimum for an enterprise as speculative as mining except in the cases of gold mines with proven reserves where the selling price of the product is fixed and there is an unlimited market. In any consideration of interest rates it must be remembered that beyond the so-called safe rate for short-term investments, the rate increases as the term of the investment increases and also increases as the risk increases. This is shown in the case of bonds by the diagram Chart 1 compiled from charts appearing on page 21 and pages 24

CHART 1



and 25 of the Federal Reserve Charts on Bank Credit, Money Rates and Business for 1940 supplemented by data for 1940 and 41 from Federal Reserve Bulletins. It is seen that Treasury notes (3 to 5 years) average 1.12 percent since their first issue in 1934, while treasury bonds (12 years or more) average 2.65 in the same period. These may be taken as standards of safety but the time when due has increased the income of the longer term bonds by 1.53 percent. Since 1919, U. S. Treasury bonds have averaged 3.52 percent; Moody's Aaa bonds, 4.45 percent while Moody's Baa bonds have averaged 6.45 percent. In other words, over these years investors have valued the additional risk in Aaa bonds over U. S. Treasury bonds as worth .93 percent. The risk in Baa bonds is similarly valued at 2 percent above that of Aaa bonds. In passing, it might

be noted that none of the bonds of any steel company are rated Aaa; none are rated Aa; a few are rated A; most, however, are rated Baa. Also it is interesting to observe the effect of times of stress on Baa bonds graphically brought out in the interval between 1931 and 1934, and to a lesser extent in 1937 and 1938. Industrial bonds possess certain advantages over investments in industrial enterprises. Investors in bonds in the classes appearing on the chart are usually protected by a first lien on property which has a value at least double the bond issue. This fact makes the payment of the bonds when due much more certain. Furthermore, bonds of this type have a very definite marketability. They can be bought and sold at will through the usual trading agencies.

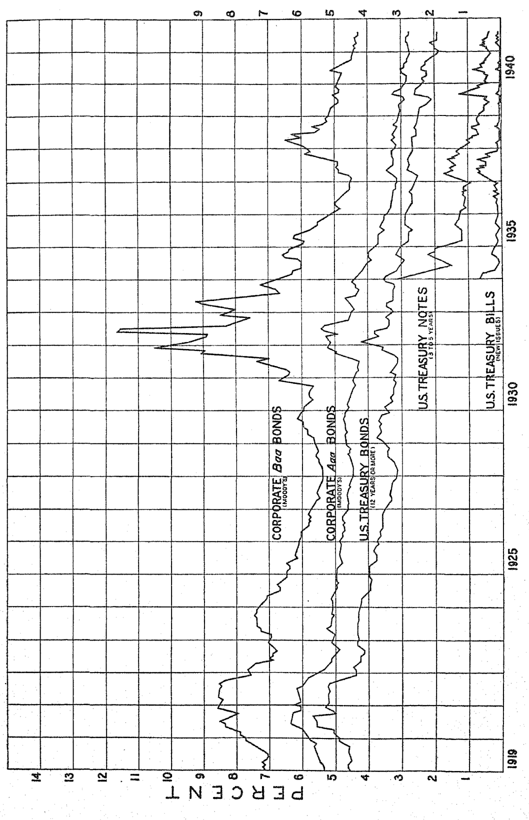
An investment in an industrial enterprise, on the other hand, has no protection and usually no market until it is an assured success. The rate to be expected is therefore considerably higher, many writers placing 8 percent as an absolute minimum, and from there on up as the risks increase.

There are many hazards or risks involved in mining. Some of these are physical hazards incident to the industry. These are generally recognized and will not be discussed here, beyond calling attention to the fact that valuation engineers consider that dependent upon conditions from two to five percent above the normal rate for industrial investments is necessary to provide for them.

What may be called the economic hazards are more serious to the purchaser of an iron mine in Minnesota than are the physical hazards. First among these is the variable market for ore. Chart 2 showing the yearly shipments of Minnesota iron ores graphically portrays this hazard, up one or two years, down the next sometimes to less than one-half of that of the previous year. Then again the capacity of the market to absorb the particular grade of ore furnished by the property. Competition from other metals or alloys is a hazard which some day may become very real. Research metallurgists are constantly searching for some alloy which will have the desirable qualities of steel without those which are undesirable. Should such a product be developed containing little or no iron the demand for ore would show a substantial decrease. Under the conditions which we face today we are confronted with the necessity of finding all possible substitutes for steel. It may well be that such substitutes will fit into our needs to such an extent as to find permanent use after the present emergency is over.

Increased competition from other states and foreign sources will tend to decrease shipments from this state when the present emergency is over. Three large developments are under way in the state of New York, one in Wisconsin and one in Texas. Over the past few years large sums of money have been spent in Alabama to increase production there. Only a few weeks ago an announcement appeared in the technical press that the Bethlehem Steel Com-

CHART 2


PERCENT
CORPORATE Baa BONDS (MOODY'S)
CORPORATE Aaa BONDS (MOODY'S)
U.S. TREASURY BONDS (12 YEARS OR MORE)
U.S. TREASURY NOTES (3 TO 5 YEARS)
U.S. TREASURY BILLS (NEW ISSUES)
1919
1925
1930
1935
1940

pany is developing a large open-pit iron mine in Venezuela, and building railroad and docks at seaboard to serve it. Soon Brazilian ore will also be coming to this country to be used by the same company.

A much longer list might be compiled but time forbids. Perhaps the most serious hazards, however, are the danger of confiscatory taxation, the danger of adverse legislation, both state and national, and the danger of bureaucratic rulings tending to stifle the industry. With the industry facing these hazards, one can hardly fail to agree with the majority of writers on valuation that at least 10 percent should be expected as a return on the investment in a mining property in this state.

But, it may be argued, money can be borrowed at a rate way below this figure at the present time. True for a short period of time and with adequate collateral. No one would hazard a guess, however, at what the rate would be over the next forty years, the estimated life of the Mesabi Range. One of the fundamental prinsiples of the theory of interest is that the rate should be at least the average rate prevailing during the period of the loan. With the rate for Baa bonds for the past twenty-two years averaging 6.45 percent, it would seem that considering the risks involved a 10 percent rate for a mining property in this state would not be excessive. The safe or sinking fund rate of 4 percent seems to most writers to be a fair rate over the years, though, of course, no one could expect such a return at the present time.

Chart 3 shows the method of computation used by the Department of Taxation to determine the full and true value of an ore body for purposes of assessment.

The Minnesota classification system in use since the early days of the Tax Commission is basically an application of the same principle, that of finding the present value of future income from various grades of ore mined by different methods.

One of the provisions of the Minnesota statutes is that iron ore whether mined or unmined shall be assessed at fifty percent of its true and full value. The rates of assessment for other property are 40 percent, 33⅓ percent, 25 percent, or 20 percent, depending upon its classification. The surface value of iron-bearing land, including buildings and fixtures, is assessed in addition as other real estate. Ore in stockpile is subject to personal property tax and assessed at 50 percent of its full and true value. The last legislature, in order to promote employment during the winter months modified the classification of ore mined on the Mesabi and Cuyuna ranges by underground methods during these months so that for two years after stockpiling its status is that of unmined ore. In order to foster beneficiation of low-grade ores the same modification was made for ore mined by open-pit methods and requiring concentration other

than crushing and screening, or both, to make it suitable for commercial blast furnace use and which is concentrated and placed in stockpile during winter months. Provision was also made for a nominal taxation on ore-bearing material in the form of taconite as another means of fostering beneficiation. In 1937 a bill was passed providing for a classification for low-grade iron-bearing formations on the basis of the tonnage recovery in beneficiation plants. Such material is assessed on this basis at from 30 to 50 percent of the true and full value.

CHART 3

THOMAS MINING COMPANY

CAMERON MINE

NE¼ of NW¼ of Section 3-57-22

MARTIN VILLAGE

Tax Rate Mills: 98.2

Computation as of May 1, 1940, of Present Worth of Estimated Future Income From Operation

PART I—ESTIMATED FUTURE INCOME PER TON:

Item	Open Pit	Underground	Total
A Reserve Tonnage in Ground, May 1, 1940	3,450,000	3,450,000	6,900,000
B Selling Value Per Ton (1935-1939 basis)	4.52	4.50	4.51
C Estimated Costs Per Ton:			
1. Mining	.270	1.40	.835
2. Beneficiation	....	....	....
3. Miscellaneous	.060	.185	.123
4. Development (Future)	.402	.042	.222
5. Plant (Future)	.204	.060	.132
6. Rail and Lake Freight and Marine Insurance	1.849	1.849	1.849
7. Marketing Expense	.050	.050	.050
8. Social Security Taxes	.020	.060	.040
9. Ad Valorem Realty Tax for Operating Period	....	....	.210
10. Occupation Tax	....	....	.100
11. Federal Income Tax	....	....	.082
D Total of Item C	....	....	3.743
E Estimated Future Income (Line B minus D)	....	....	.767
F Less Return of 6% on Future Investment in Development and Plant and on Working Capital	....	....	.232
G Balance of Future Estimated Income (E–F)	....	....	.535

CHART 3—*Continued*

PART II—COMPUTATION OF PRESENT WORTH (RG. LIFE 38 YEARS):

H Present Worth of Item G for 35 Years at 7% and 4% (Factor .341856)	....	....	.1829
I Less Inactive Tax for 3 Years and Ret. at 6%	....	....	.0272
J Balance Present Worth Before Deferment	....	....	.1557
K Present Worth Def. 3 Years at 6% (Factor .83962)	....	....	.1307
L Final Computed Present Worth, Per Ton	....	....	.1307
M Final Computed Present Worth at .1307 × 6,900,000 Tons. Full and True Value	....	....	$901,830

Operating Life, 14 Years.

The 1941 session of the legislature also provided for a reduction in per capita levies from $70 to $50 in the case of cities and villages and from $60 to $40 in the case of school districts, such decrease to be at the rate of $2.50 per year for a period of 8 years.

In 1921 the legislature passed an occupation tax law making every corporation or person mining or producing ores in the state subject to an occupation tax, the tax being based on the value of the ore at the place where mined less certain deductions specified in the act. These deductions are as follows:

1. Cost of labor and supplies.
2. An allowance for the removal of overburden in the case of open-pit mining.
3. An allowance for shaft sinking and drifting in the case of underground mines.
4. The amount of royalties paid on the ore mined during the year.
5. A percentage of the ad valorem taxes levied for the year against the realty in which the ore is deposited equal to the percentage that the tons mined or produced during such year bears to the total tonnage in the mine.

The valuation under the laws of 1921 was subject to a tax of 6 percent. Since that time the rate has been changed from time to time. For the years 1941 and 1942 the last legislature set the rate at 10½ percent subject to the allowance of a credit based on employment. This provision is that for the purpose of increasing employment and the utilization of low-grade, underground and high labor cost ores, any taxpayer shall be allowed a credit amounting to 10 percent of that part of the cost of labor excepting administrative

labor, employed at the mine or in the beneficiation of ore in any year, in excess of 20 cents per ton of ore produced during that year. In no case, however, is the credit to be in excess of two-thirds of the tax as originally computed.

A comparison of the occupation tax with the state corporation and franchise tax reveals the fact that the latter is much the more liberal in the matter of allowable deductions. To determine net income the income tax law allows the deduction of all real estate taxes paid during the fiscal year. The occupation tax law allows but a small fraction of this amount depending on the ratio of shipments to reserves. Furthermore, in the case of a corporation the ad valorem tax on all non-operating properties of the taxpayer is deductible from the gross income. In the case of mining companies holding large reserves this is a very important item. Depletion is an allowable deduction under the income tax law, not so under the occupation tax. Federal income tax is likewise deductible under the income tax but not under the occupation tax. With the present federal rate on corporations this is a considerable item. The royalty paid is deductible in both cases but the royalty tax is not deductible in the case of the occupation tax. There are in addition certain cost items allowable under the income tax but not under the occupation tax, which total an appreciable amount. If all of these deductions were allowed the occupation tax would be cut in half at least and in many cases would be lessened to a third or even a fourth. In other words, depending on the company, its reserves and other factors a 10½ percent occupation tax is equivalent to a corporate income tax of from 20 to 45 percent. Furthermore, the gross value for the occupation tax is computed on the Lake Erie price while for income tax purposes it would be based on the price actually received for the ore.

The legislature of 1923 as a complement to the occupation tax provided for a royalty tax of six percent on all royalty received during the calendar year for permission to explore, mine, take out and remove ore from land in this state. This tax was not passed as an additional tax to be paid by the mining companies, but it was expected that it would be a charge against the fee owner. Unfortunately, the leases contained a clause that the lessee should pay all taxes and assessments "ordinary and extraordinary, general and specific" levied or assessed upon the land and on the iron ore mined thereon. The Supreme Court ruled that the mining operators must pay the tax rather than the fee owner. It thus became an additional tax on the industry. The rate of the royalty tax has been changed by various legislatures to parallel the rate of the occupation tax and for 1941 and 1942 will also be 10½ percent.

The last biennial report of the Department of Taxation shows that over the past 19 years the ad valorem tax has resulted in an average

cost per ton of ore produced of 59.0 cents; the occupation tax, 9.7 cents; and the royalty tax 2.3 cents. This makes a total tax of 71 cents per ton on all ore mined and shipped. A second table in the above report shows that the cost per ton for taxes amounts to one-third of the total costs of mining including taxes. The tax cost per ton in this state is over three times that which any other state exacts from the mining industry. Part of the ad valorem taxes go to the state, part to the county and part to the local communities and school districts. The occupation tax goes to the state where 50 percent goes into the general revenue fund and the balance into trust funds. Five percent of the amount of the occupation tax going into the general revenue fund for 1941 and ten percent thereafter is appropriated to an Iron Range Resources and Rehabilitation Commission. The royalty tax all goes into the general revenue fund. Of the tax dollar paid by the mining companies the local communities and school districts receive, on an average 59.57 cents. The county receives 16.69 cents and the state 23.73 cents.

For the benefit of those from other states who may feel that they are losing a golden opportunity in not emulating this state two quotations from the eleventh biennial report of the Minnesota Tax Commission for 1928 are worth considering.

> "We believe that a careful study of the present and past conditions of our mining industry will convince any impartial investigator that existing conditions are much less favorable than they were a few years ago. These unfavorable conditions not only affect those directly engaged in mining activities, but react with equal force on those sections of the state that must, of necessity, measure the prosperity of the laborer and business man within their limits by the prosperity of the mining industry. The welfare of the industry means the welfare of the community. A survey of present conditions discloses some startling changes in recent years. Inactivity has taken the place of activity in many mining districts. Numerous prosperous communities of a few years ago are rapidly dwindling in population and wealth, and, unless conditions change, will soon cease to exist."

> "We believe the mining industry should bear its fair share of the general tax burden, and that it should be as heavily taxed as any other industry, but we do not believe that it should be either paralyzed or destroyed through taxation. While fully realizing the heavy tax burden borne by property in general, we believe that the tax exactions required of mining property are relatively greater than those required of any other class of property; that taxes on the mining industry are not only burdensome, but unreasonably oppressive, and eventually will react to the disadvantage of the entire state."

The entire statement under the heading "Conclusions and Recommendations" appearing on pages 140 and 141 of that report is worthy of thoughtful consideration.

What has happened since seems to bear out these predictions. One company which in 1920 operated 20 mines now operates 6, another operating 11 in 1920 now operates 2, a third operating 10 in 1920 now operates 4, a fourth operating 8 in 1920 now operates 3, a fifth operating 6 in 1920 now operates 1. These companies are all operating units of large steel corporations. Many of these properties were mined out but were not replaced by others in spite of the fact that the records of the Department of Taxation show that there are available 155 million tons of ore, unleased in the hands of fee owners. Furthermore, these companies are all opening up deposits in other states, four of which are in New York, a number in Michigan, one in Wisconsin and several in Canada. One executive in discussing the matter stated that his company was going to states where they thought more of employment and payroll than they did of "soaking the mining companies with high taxes."

I cannot speak with authority for any other industry but I know that every well-managed mining company in this country is constantly studying costs and they have learned that the saving of a tenth of a cent here, a quarter of a cent there and small fractions per unit of production at other places mean the difference between profit and loss. Government units could well emulate their example. The relief from lack of revenue is not so much more revenue as it is the same study which industry gives to expenditures. Securing a dollar's worth of value for every dollar spent and effecting savings wherever possible would work wonders.

In conclusion, there is a thought which I would leave with the members of this association.

The taxing units throughout this nation should become more concerned with the establishment of thriving industry and payrolls and less concerned with the exaction of high tax revenue. In other words, "it should be the object of wise taxation to preserve and strengthen the economic structure and to raise revenue without encroaching unduly on the potential revenues of the future."

MICHIGAN SYSTEM OF MINE APPRAISAL

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Appraiser of Mines, Michigan

INTRODUCTION

The Michigan State Tax Commission has appraised the iron mines of Michigan each year for the last thirty years with the exception of 1912; the copper mines in 1911, 1919, and every year since 1924; the coal mines and quarries in 1911 and whenever conditions indicate a re-valuation is necessary.

Previous to 1911 the mines in each of the districts were assessed by the local supervisor or assessing officer. It can readily be seen that the local taxation of mines was a political football and it was the subject of heated discussions in political campaigns, both local and state-wide. It occupied the attention of the Legislature, the State Grange, and other interested bodies, and there was a general feeling throughout the state that the mines were under-assessed.

This conditions was recognized by the Legislature and in 1911 they appropriated money for making an assessment of the mines. Dr. J. R. Finlay was employed to make this original appraisal. He was aided by Dr. C. K. Leith on the iron mines; Mr. W. Hague on the copper mines; and Dr. H. M. Chance on the coal mines, salt wells, and quarries. Dr. Finlay's original report increased the value of the iron mines from $26,987,000 to $119,485,000. This latter valuation was subsequently reduced, following public hearings, by the Board of State Tax Commissioners (now the State Tax Commission) to $92,631,000. These increases in assessments (something in the neighborhood of 400%) were hotly contested by the mine officials, and two court cases—the *Newport* and the *Brotherton*—arose out of this controversy. The court held in both cases that the valuations were equitable and that the method by which they were arrived at — that is, the Finlay, Hoover, or Michigan System — obtained proper valuations.

The Tax Commission, having found in their opinion that fair valuations were thus being determined for tax purposes, deemed it advisable to make annual re-appraisals of the iron mines. This was the origin of the present cooperation between the Tax Commission and the Department of Conservation. This arrangement was sanctioned by the Legislature of 1913, and the State Geologist became Appraiser of Mines. The original act provided an appropriation for the appraisals of 1914 and 1915. Although no further appropriations have been made, the cooperative arrangement has since been carried on.

THEORY OF MINE APPRAISAL

There are many reasons why the mines are assessed each year by the State Tax Commission. A few of the more important ones are:

(1) Mines are rarely sold; hence local assessors have few sales by which they can measure values. When mines are sold, the sale is usually so confused by exchange of other property, lease provisions, exchange of ore, prepaid royalty, and so forth, that it is difficult to arrive at what may be considered a true cash value.

(2) Mine appraisal is a very technical procedure that requires knowledge and experience in the mining business that is possessed by but few local assessors.

(3) Local pressure or favoritism is apt to influence local valuations. Usually in these assessing districts the mining industry over-

shadows all others in importance. Values of the mines are greater than the value of all other property. This at once gives rise to political and economic control of local public affairs by the mining companies, which includes assessment of property for taxation. By this it is not meant, however, that mining property was assessed prior to 1911 to the enormous disadvantages of other property, for records show that at that time all property was under-assessed.

(4) Individual mines are often located in two or more adjoining assessing districts, and agreement between affected assessors or supervisors would be difficult.

(5) The big problem in mine appraisal is equalization between mines. This cannot be obtained by many appraisers but can be approximated by one appraiser.

(6) An annual re-appraisal of the iron mines is necessary because these properties fluctuate in value to far greater extent than do other classes of real estate. Each year ore is being taken out of the ground and new ore is added through discoveries, development of new levels, and extensions of ore bodies. Further, grades of ore change in a mine from year to year; economic conditions or trade practices which favor or penalize certain grades of ore also change. Both of these factors are important in determining the present value of the ore in a mine. The fluctuation in total value of all mines is, of course, not as great as the change in individual properties.

In Michigan no distinction is made between the various classes of real property. Section X of the Constitution states that, "All property shall be assessed at its cash value." The Legislature later interpreted this portion of the general tax law by defining it as "The usual selling price at the place where the property is located, being the price which could be obtained at private sale and not at forced or auction sale."

The Michigan System of mine appraisal has often been spoken of as the "Finlay Method" or the "Hoover Method." However, the Michigan System differs from the original Finlay Method in many ways, the principal differences being:

(1) The Michigan method is comparatively elastic, and less rigid rules are followed.

(2) Interest rate now used is 6% on both capital and sinking fund, while Finlay used 5% and 4% respectively.

(3) In the valuation of undeveloped or unproductive mines, earnings are deferred and proper allowance is made for the development period.

(4) The Finlay method of valuation did not include ore in stockpile. This ore is included in the valuation under the present system.

(5) Finlay did not appraise unprofitable operating properties. These are now valued according to the judgment of the appraiser because it is supposed that a mine would not be operating unless it is worth something.

(6) With the low rate of interest now used, hazard allowances are applied to the various factors according to the appraiser's judgment. These factors vary with the mines, and have been found preferable to the sliding scale of interest.

(7) Finlay estimated future prices of the product. In the present method the five-year record of selling prices and operating costs is used as a guide.

Essentially the Michigan System is an estimate of the present worth of future expected profits. The factors used in the calculation of valuation are reserves, annual shipments, life, profit factor, interest rate, and hazard. Of these factors the estimation of reserves and profit factor are probably the most important, and adjustments in either of these two factors will probably affect the final value to a greater extent than any other factor.

FACTORS OF MINE VALUATION

In estimating the reserves of an iron mine there is no set rule which may be applied indiscriminately to all properties. This is because of the wide variation in physical or geological conditions in the various mines and mining districts. Generally the ore is considered in two classes — first, developed ore or ore in sight; and second, prospective ore. It is evident that the estimate of developed ore in a mine may be made with comparative ease, but the tonnage of prospective ore is largely determined by a knowledge of the geological conditions existing in the property. It certainly would not be equitable to appraise a mine on the basis of developed ore alone; neither would it be equitable to appraise it on the basis of speculative tonnage far in advance of a reasonable extension of known ore bodies. In considering prospective tonnage, it is evident that a partially developed property located in a district where ore concentration is known to extend to 4,000 feet has more value than a similar property in a district where concentration is believed to play out at 1,000 feet. This speculative feature is of utmost importance in the valuation of a mine, and as it is essentially a matter of tonnage, the future possibility is logically represented by the use of probable speculative tonnage beyond that which can be actually measured.

The profit that is used in the Michigan System is not the true profit that accrues to the operator, in that royalty and depreciation are figured as profits and not as expense. The actual profit per ton is ascertained for each mine from the actual operating financial record over the preceding five-year period, which period has been found to be most suitable. A longer period would bring into the calculation the record of earlier years which probably would not be significant in view of modern mining equipment and methods. On the other hand, if only one, two, or three-year periods were used, it could be fairly argued that the experience of this short period was

not a fair measure of the future. It is, of course, obvious that a new or undeveloped property, or a property which has been abandoned for many years, has no operating record from which profits may be calculated. For these properties the experience of mines operating under similar physical and geological conditions is used as a guide.

It is apparent that the product of the total reserve of a mine and the calculated profit would give a value far in excess of the present worth of the property because the physical and market conditions limit the rate at which the ore can be mined and sold. Only a fraction of the reserve is mined annually and the profit is realized as an annual income from year to year. In estimating the life of a property, the past five years is used as a guide. However, a knowledge of market conditions during the past five years, as compared with the possibilities for the future, is invaluable in estimating the future annual shipments and the life of the property. For example, with the present stimulation in the iron mining industry due to national defense, one would certainly not use the five-year record of a mine which included two years in which the mine was being rehabilitated or recovering from the throes of a depression.

At the time of the original appraisal by Mr. Finlay there was a great deal of discussion relative to the rate of interest chosen for interest on capital, and for the return of the investment. It was thought by many that as mining is a speculative enterprise, the return for the risk involved should be greater than that allowed for a non-speculative venture. It was contended that the sinking fund rate should be low because of the fact that the sinking fund should be set up on a safe basis, and that securities paying 6% were not conservative enough to warrant their use in a sinking fund. However, the commission desired to follow the lead suggested by Mr. Finlay, which was to eliminate many of the speculative phases of the valuations insofar as possible, before the interest rate entered into the computation. Relative to the sinking fund, in actual practice this money is not placed in a sinking fund but is usually reinvested in the mine itself or in other mining operations. Hence the commission believed that 6% was justified here.

It has been found that it is very difficult to estimate either the future costs or the future sales price of the mined product. However, a study of mining records shows that the cost and selling price of ore has moved up and down together and that over a number of years the variation between the two has been less than the variation of either of the two items. It is therefore easier to project into the future the past profit than it is to project the cost and selling price.

The selling price used in the computations is the published Lake Erie price. Some yardstick such as this has to be used because of the fact that only a small percentage of the ore mined and sold is sold on the open market. Most ore sales represent nothing more than a book-charge made between the mining subsidiary and the

steel consuming department. The assessment of the Michigan mines is therefore based upon the published price because the assessment of mines for tax purposes is largely a matter of equalization between the mines, and its use in the determination of the profit factor is fair to all mining properties.

After the determination has been made of the factors of reserve, life and profit, each factor is carefully studied and adjustments are often made which will bring each one into line with future conditions which might be expected; i. e. if a large volume of water is encountered, greater depth is necessary, or hoisting and maintenance charges are likely to increase. Changing geological conditions are considered; also changes in metallurgical practices which may make it difficult or impossible to use an ore that had readily been sold in the preceding five-year period.

Following the adjustment of these factors a preliminary valuation may be calculated. However, in the valuation of many mines there are certain conditions which the adjustment of the basic factors does not recognize. Among these conditions may be listed: possible hazard of inflow of water, failure of pillars, sulphur fires, possible necessity of replacement of a shaft due to subsidence or movement, sudden termination of an ore body against a fault, an abrupt change in grade of ore. These factors can best be recognized by applying to the tentative computation a hazard factor. This factor varies in the individual mines; in practice in Michigan, it varies from 5% to 20%.

Certain costs, the more important of which are royalty, depletion, and interest on borrowed money, are not allowed in the appraisal. Because mining property is valued as a unit, Michigan does not recognize any separation between operating interest and fee interest. Depletion is accounted for in the present worth formula, in that each year a certain amount of ore with a definite value is taken away from the mine, and each year the decrease in the life of the mine brings the book value down to nothing at the time of the exhaustion of the reserves. Interest on borrowed money is not an allowable cost because anyone buying a property would not logically consider this a cost he would have to bear. Depreciation is hardly an item of cost to be used in computing future profits. The purchaser of a mine is not interested in what is being charged off but is concerned about what he will have to spend in the future for new construction and machinery.

Originally a charge for construction and installation was allowed, but this was found to fluctuate largely both for individual mines and from year to year, but for a group of range mines it approached very closely the charge made for depreciation. The large variation in costs did not fit in well with the appraisal as it is well for both the mines and the communities in which they are operating to keep the assessments on a fairly uniform basis. For that reason depre-

ciation was substituted for construction and installation, and has since been used except where this item does not give a true picture of conditions.

In contrast to the original Finlay appraisal, it is the policy of the Tax Commission, under the Michigan System, to consider the value of the stockpile as a part of the value of the mine. The reason for this is that since the expected profit is assumed to be the difference between the cost of producing and selling the ore and the price received, it is apparent that all ore on a property should be considered in the same manner. There is no greater profit to be gained from a ton of ore in stockpile than a ton of ore in the ground. Actually, the profit to be realized from a ton of ore in stockpile is less. This is due to the charges involved in placing the ore in stockpile, the interest on the money spent in mining the ore, and the charges for loading the ore into railway cars for shipment.

Further, the inclusion of the stockpile ore as part of the mine in the valuation stimulates winter employment and operation during times of slack demand for ore. No mining company could afford to work its mines during such periods if, in addition to the investment necessary to produce this ore, it was subjected to an increased tax burden. For example, during the depression year of 1931 two million more tons of ore were mined than were shipped, and operations were carried on primarily for purposes of providing employment. There is little doubt that most of the mines in the state would have closed down during that period if the stockpiles had been considered separately from the mines and an additional assessment placed upon them.

APPRAISAL PROCEDURE

The procedure and mechanics of the Michigan mine appraisal is as follows:

Maps, drill records, cross sections, and engineering estimates as of January 1st of each year are submitted to the office of the Tax Commission or appraiser and the engineering estimates of reserves are studied. Following this preliminary study, an examination trip is taken by the appraiser through most of the active mines at which time the mine maps are compared with the actual underground openings and reserve tonnages discussed with the company officials. An appraisal estimate of reserves is then made which is almost invariably higher than that submitted by the company. The reason for this is that while it is proper for a company to make a certain estimate for mining purposes, an appraisal estimate which gives more recognition to the speculative possibilities of a mine is equally proper. This speculative tonnage would always be considered by a buyer of a mining property.

On March 15th the records of costs and selling prices for the past five years' operations are submitted by the companies. These sworn

statements are analyzed, studied, and compared with costs of mines operating under similar physical and geological conditions.

The actual procedure of calculating valuations is then begun. This involves, on the part of the appraiser, a study of the geology of the mine, the mining method, analysis of operating costs, selling price of ore, efficiency, and other factors which go to make up the final valuation. Tentative valuations are then submitted to the mining companies, who are given an opportunity to come to Lansing to present additional information on their properties or to argue these tentative valuations.

Following these conferences, final tentative valuations are made, one copy of which is sent to the mining company and one to the local assessing officer of the district in which the mines lie. This is usually about ten days in advance of the public hearings which are held the middle of May at the respective county seats. At these hearings both the operating companies and anyone from the local communities who may be affected by the valuations have a chance to be heard. The appraiser's figures are then reviewed and final valuations recommended to the supervisors by the Tax Commission. These valuations are in most cases placed on the rolls. However, either the local communities, the mining companies, or any other affected person, may petition for a review by the Tax Commission. The results of such review are final and the valuations so determined are placed on the roll by the Tax Commission.

THE THEORY OF THE AD VALOREM TAXATION OF MINES

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Debate over the ad valorem method of taxing mineral deposits was vigorous during the last war, and economic theory was enlisted by both sides of the controversy. The most important studies on the subject were the 1913 report of the Arizona Tax Commission, the report of the New Mexico Special Revenue Commission of 1920, the monograph on *The Taxation of Mines in Montana* by Louis Levine (1919), the report of the Committee on the Taxation of Mines and Mineral Lands of the National Tax Association, in 1913, and the book by L. E. Young on *Mine Taxation in the United States*. All appear to have been influenced to a greater or less degree by the work of C. M. Zander, dynamic Tax Commissioner from Arizona and chairman of the Committee of the National Tax Association, and all, with a few reservations, endorsed the use of the property tax on mineral deposits.

With equal unanimity the mine owners opposed this tax. They felt that because of the uncertainties of mining, deposits were not subject to accurate valuation, and they maintained that the fact of

depletion distinguished the taxable capacity of mines from other property. The formal mine tax studies disposed of these arguments rather readily. Mines were obviously valued for purchase and sale, and the same methods, they said, could be used for tax assessment. Many other kinds of property, such as office buildings, were subject to a sort of depletion and yet were valued for tax purposes. The ad valorem tax, even though apportioned according to sale value of property, is supposedly paid out of income each year, and thus does not ordinarily accumulate against the property itself. Yet the fact that mine owners have never willingly submitted to the ad valorem tax and, when they dominated a community as in Nevada, always apportioned the tax burden among themselves in some other fashion, is of significance in a democratic government. It is always possible, and I think it is true in this instance, that the instinctive dislike of the ad valorem tax may have a stronger basis in theory than the mine owners have been able to put in words. It will be the first purpose of this paper to restate the mine's case, to remove from the ad valorem mine tax the cloak of academic preference and thus to simplify the issues.

From the academic point of view the actual, but unspoken, reason for assessing mines with other forms of property is the need for some sort of uniformity in the tax base. Where the property is homogeneous the need is a vital one, for without uniformity in law the continuous drive for special measures is apt to fill the lobbies with excitement and the future of business with uncertainty, especially during a period of rapid economic change. But uncertainty and legislative activity can spring from other sources than lack of uniformity in the tax base, and the striking differences between mineral deposits and other types of property have in some cases caused uniformity of treatment to defeat its own purpose.

The property tax is merely another of that endless number of compromises necessary to democratic government. It is acceptable largely because property in a rural community gives a rough measure both of benefit from government and ability to pay, and because the income therefrom fluctuates only moderately more than the value of the property, so that the tax, measured on that base, can normally be paid out of income. The sales value of a farm, moreover, can be determined with an acceptable degree of definiteness. In none of these respects are mineral deposits on a parallel with farm land. They do not bear the same relation either to benefit from government or to the need of the community for revenue, nor are deposits subject to the same type of valuation.

From the tax standpoint mineral deposits show differences both of degree and kind from other forms of property. A community consisting entirely of mining companies would consider that very few government services benefited owners of mineral deposits only in proportion to the engineering estimate of the present worth of

those deposits. It would be equally difficult to establish the fact that in a town like Hibbing, Minnesota, the benefit of the various public services is distributed between mine owners and the rest of the populace according to tax payments. Uniform application of the property tax under such a condition of wide divergence between taxation and benefit shifts the political contest from a struggle over methods of taxation to a struggle over the height of expenditure, as the histories of Arizona and Minnesota well illustrate. While in most cases this transfer of the point of political pressure probably results in a net gain to the community, it is still accompanied by some degree of demoralization, as in the Mesabe Range communities.[1] This is not an effort to establish the doctrine of taxation according to benefit, but only to say that one of the primary functions of a tax system is to determine the scope of governmental activity, and the tax can diverge so far from benefit as to fail in this function.

One of the reasons why land and capital investments can be used as a tax base is that their value is apportioned about the country in some rough relation to population and the needs of government. Such is less true with regard to mineral deposits than to the capital investment in and about the mine.

The fact that the period of exploitation of deposits is limited over time differentiates them in another way from other property. Three illustrations come to mind. In southeastern Kansas, where a portion of the "tri-state" zinc deposits lies just under the surface of the farm land, it is customary for companies to lease the right to mine from the farm owners, paying a sort of crop rental in a percentage of the value of the ore mined. But while the farmers obviously have a valuable property right in such deposits before they are exploited, it is not customary to assess them on this right until the mines commence operation, on the grounds that few farmers would have the capital required to pay a tax on these anticipated earnings. The difficulty is not insurmountable, of course. To give each of these known deposits a value and to tax them accordingly would drive them into the hands of the mining companies, under such terms as would arise in what would doubtless be a "buyer's market." But the precise outcome of such a tax program is difficult to forecast, and it is sufficient to point out that while a farm is assessed on the present worth of future income, it is expected that the tax itself will be paid out of present income. Where, before the operation of the property, there is no income, the system loses some of its merit.

Of greater importance is the fact that toward the end of the mining operation there is little of value left to tax. For many years, in the state of Michigan, some of the older mines have been oper-

[1] On some aspects of the problem see Report of the Minnesota Interim Commission on Iron Ore Taxation, 1941.

ating with just sufficient income to pay the direct costs and the most necessary overhead expenses. By the calculations of mining engineers the "present worth" of these ore deposits to any buyer would be almost nil, and the equipment of such a mine has only scrap value. A reasonable approach to a situation of this sort is that taken by the mine owners who agree with the assessor that a certain requisite minimum of local and state taxes is a part of the cost of doing business, and assess themselves. But an equally scientific method would be to accept taxes as a part of cost and to use some arbitrary but definite combination of gross and net production as a tax base, as is done in many western states. The collapse of the ad valorem system toward the end of the mining operation is inherent in the nature of mining property.

Finally, high per capita expenditures in the municipalities of the Mesabe Range will show a tendency to remain high, regardless of the steady depletion of the deposits, and, unless the state intervenes, might eventually raise the marginal cost of ore and affect the competitive position of the Minnesota mines.

The most common objection to the property tax on mines—that mines cannot be valued accurately—must be stated carefully. An essential characteristic of a tax base is that it be definite, as a sale price is definite. The acceptability of the property tax in a rural community rests largely on the fact that the assessor can reason roughly from actual sales values of farms to the probable sales prices of other farms and the property owner can check this reasoning without too much expense. The greater the proportion of farms sold, the more definite the assessment base, and there has been a rather continuous market for farms on this continent. But it would be difficult to imagine a farm assessor estimating future costs and prices for farm products and calculating by formula the present worth of the anticipated future profit. The very formula would stagger him. The valuation given to a mine by an engineer is not a sales price and is not a definite and incontroversial sum. In every purchase of a mine there is an additional matter of judgment—judgment of future prices of ore, of future costs of mining and even judgment of the judgment of the engineer. Present worth, as calculated by the engineer, is the value of a mine only if it is bought at that figure, and it approaches true value only to the extent that it allows the relation of this mine to comparable mines recently sold. But in many areas mineral deposits lack uniformity in character, and in other areas sales are infrequent. In the iron-mining districts even the sales of ore are few. The engineer's evidence in such a circumstance is still "the best evidence" of what the property might bring, but it does not have the certainty of a sales price.

Some proponents of the ad valorem tax answer this charge by proposing that in recognition of the difficulties surrounding mine valuation, each deposit might be assessed conservatively, on known

and proven ores only. The difficulty with this suggestion is that methods of tax administration are as much the product of pressure groups as are the tax laws themselves, and a state so dominated by the non-mining interests that it can enact a property tax on metal mines is apt also to elect tax commissioners who give the benefit of the doubt to the non-mining interests. In the same fashion, the local farm assessor has always tended to let the uncertainties of valuation accrue to the benefit of his constituents.

Whatever may have been their contributions to more exact tax administration, tax commissions have quite often had their origin as weapons of an aggressive political pressure group. Such was the lusty inception of the tax commissions of Michigan, Minnesota, Arizona, New Mexico, Nevada, Colorado, Utah, and Montana. Further study of state histories would doubtless materially lengthen the list. These commissions were the product of political contests over the distribution of the tax burden between rural and corporate groups, and were established as an addition to or in lieu of the tax measures which the majority sought to place upon corporate capital or income therefrom. To a greater or less extent they owed their life to a dissatisfied farm element, and in varying degrees therefore they have been political rather than administrative bodies. Arizona was long the outstanding illustration of the administrative weakness and political strength of an elective tax commission with a direct and unmistakable mandate from the agrarian bloc.

For various reasons therefore no state with the ad valorem mines tax on its statute books has shown a genuine and continuous effort to enforce it. In the first place they all tend to exempt the most uncertain mining claims. Michigan has found it necessary to compromise with mining companies and place a fictional valuation upon mines that have been so far worked out that they cannot be assessed on their history. The mining companies, in this case, recognize that the support of the local community, like the wage bill, is a part of the cost of doing business. The State of Arizona once hired J. R. Finlay to make an appraisal but found his valuations unacceptably low and did not make another general engineering assessment until recently. The Arizona commission, in its early years, however, did use a formula for capitalizing net income, and until the late twenties and early thirties apparently utilized stock and bond quotations where such was possible. New Mexico followed Finlay's valuations long after they could have been valid and has had only that one authoritative assessment. The trial court in the *Oliver Iron Mining Company* case was unable to find that the Minnesota State Tax Commission had made any present-worth calculation of the value of the deposits. Kansas has never tried an engineering valuation. Only two have been made of the coal and ore in Alabama.

A study of the history of the ad valorem tax on mining indicates, therefore, that the capital investment in a mine corresponds more

closely to the normal property tax base than does the deposit itself, and the use of some arbitrary but definite combination of gross and net income as a substitute for the valuation of the deposit, is entirely defensible from the academic point of view.

This is not, of course, an attempt to summarize the advantages and disadvantages of various methods of mine taxation. The ad valorem tax has many advantages, particularly to the non-mining portions of the state. In some states it enabled the non-mining interests to enlist the institutional pressures for uniformity in the tax system to increase revenues from mineral deposits. During a depression more of the burden is carried by the mining companies and less by state employees, unless the alternative, gross-and-net income, base is averaged over time. But if the student of taxation is to take the point of view of no single interest, in a contest as intense as this, he would do well to start with that of the common law and the courts. The law has always recognized the necessity for finding a relatively stable compromise between conflicting groups. Because law and government are products of conflict, it is true, as Adam Smith recognized, that one of the most important elements in revenue law is certainty, and to this end both the courts and the students of public finance should be able to make some contribution.

Both the courts and the academic students are in a difficult position on this problem, because as Bentham pointed out a century ago, certainty in law comes as much by an acceptance of the social will as by doctrinaire insistence upon conventional patterns.[2] If the public insists upon the taxation of a deposit that cannot, actually, be valued, the courts can hold neither the tax commission nor the mine owner entirely responsible for proving beyond doubt its proper assessment. Here lies the most important single problem in ad valorem mine taxation—that of the distribution of the responsibility for administration. The dissenting opinion in the *Oliver Iron Mining* case maintained that the burden of proof that a valuation was erroneous lay with the property owner, and the opinion in the *Phelps Dodge* case suggested rather clearly that the court had found the problems difficult and had decided against the company because its contentions with regard to future costs and prices were not convincing.[3]

But in deciding how the burden of proof should be distributed we should probably take into consideration the fact that it was the public rather than the mines which insisted on the ad valorem tax. The tax was not, as among farmers, self-imposed. Is it not possible that the relative freedom from responsibility enjoyed by the tax

[2] See Holdsworth, W. S., "Blackstone's Treatment of Equity," *Harvard Law Review*, 43:20 (Everett Edition of Bentham, 1928, p. 214).

[3] *State of Minnesota* v. *Oliver Iron Mining Company et al.*, Trial Court. See p. 326, Vol. I of record before State Supreme Court, 1935. *Phelps Dodge* v. *Frank Luke et al.*, Memorandum decision, filed with Clerk of District Court, Tucson Division, Nov. 3, 1936, p. 29.

commissions has contributed largely to the fact that not even in other phases of the property tax has there been such cynical administration? In several important court cases the tax commission has never attempted to substantiate its original valuation but has hired an engineer to make a new one, lower than the original but as high as he believed he could defend with dignity before the court.[4] The court, then, has been forced to listen to involved, technical, and conflicting testimony over valuations not originally imposed, and attempt an assessment of its own. It has undertaken this duty with expressed reluctance, as in the *Oliver Iron Mining Company* case, but there has appeared to be no other way out of a difficult political, economic, and legal situation.

A recognition of the fact that pressure group conflict finds expression in administrative partiality, is not necessarily a recognition of the necessity for the extent of that partiality. To curb in a measure the public desire for administrative, extra-legal over-assessment or under-assessment of property would still leave open the opportunity for a change in the law itself. While the law must presume, without evidence to the contrary, that the assessor has acted in good faith, it insists that he use his discretion and that he avoid arbitrary valuations. It is difficult to see what harmful repercussions would result from a recognition of the obvious fact that without a somewhat regular use of available engineering data a mine valuation must of necessity be arbitrary and without administrative discretion. On the other hand, the placing of more of the burden of proof and responsibility for assessment upon the administrative body might have several beneficial results. If it should eventually develop that because of increasing integration of companies there was a lack of sales either of ore or of mines, the state would be made aware of the extent to which mine valuation had become impractical. If we should anticipate, on the other hand, a continued adherence to the ad valorem system, a capable engineer using all the data available can undertake those arduous duties of arbitration which, as in the *Oliver Iron Mining Company* case, the court has been compelled unwillingly to carry. An honest and genuine effort on the part of the tax commission to use available data for property valuation is a recognized step toward a lessening of litigation and of related political frictions.

For thirty years the geologists in the Michigan Department of Conservation have set a standard for other important mining states, and in mine tax administration the State of Michigan still appears to lead the way. With some security of tenure and relative freedom from direct political pressure, this office has been a constructive influence in the economic and political development of the State. Its history furnishes one of the bright spots in the story of mine taxation.

[4] See, for instance, *State Tax Commission et al.* v. *United Verde Extension Mining Co.*, 4 Pac. (2nd) 395, and *Oliver Iron Mining Company* case.

SIXTEENTH SESSION

WEDNESDAY, OCTOBER 15, 2:10 P. M.

Ballroom, Lowry Hotel

HAROLD M. GROVES, presiding.

CHAIRMAN GROVES: I suppose after the exciting discussion of the federal income tax yesterday that most any discussion of the state income tax might seem in the nature of an anticlimax, but I think our subject is of special interest at this time, partly perhaps because the death sentence for the state income tax has at least been mentioned.

It is also true that while twenty-odd years ago at the time of the World War only a very small minority of the states had a state income tax, at the present time almost two-thirds tax personal incomes. Of the states in this immediate vicinity, this State of Minnesota, Wisconsin, Iowa, North Dakota, all have state income taxes, and the institution has been warmly and frequently debated in other surrounding states that do not have such a tax.

The first subject on the program deals with the matter I first mentioned, that is, "The Place of State Income Tax in a Period of Expanding Federal Fiscal Needs." A friend of mine suggested that this paper might be short and follow the model used by a well-known architect who talked on the subject of the future of art. He said, "Ladies and Gentlemen, my speech will be very short. I am to talk on the future of art in the United States, and the answer is, there isn't any." Nevertheless, this first paper, as I happen to know, is a very considerable manuscript. Unfortunately, Mr. Ecker-R. of the Division of Tax Research of the United States Treasury Department is unable to be here to present his paper. He prevailed upon me to read it for him, though I want it understood, as he would, that this is his preparation, and not mine. I shall take just a few liberties with his paper, in order to keep it within the 20-minute limit, as I am sure the Chairman should do in starting off this very considerable program.

THE PLACE OF THE STATE INCOME TAX IN A PERIOD OF EXPANDING FEDERAL NEEDS

L. LASZLO ECKER-R.
Division of Tax Research, U. S. Treasury Department

The subject assigned me calls for a discussion of the future place of state taxes on personal net incomes in the American fiscal system. The principal point at issue is whether the states should remain in the income tax field. The three possibilities are: (1) The states and the federal government might continue to share the field; (2) the states might withdraw and leave the field to the federal government; or (3) the federal government might withdraw and leave the field to the states. A fourth—the federal government and the states both withdrawing from the field—needs to be mentioned only in the interest of logical nicety.

The third possibility—the retirement of the federal government from the personal income tax field—can also be dismissed from consideration. The Proceedings of the First National Conference on State and Local Taxation held under the auspices of this Association in 1907 record, in support of exclusive state taxation of incomes, the argument of the then Governor Guild of Massachusetts that the states have a prior claim to the tax, and the argument of Professor C. L. Raper, then of the University of North Carolina, that the states have a closer relation to the citizen than the federal government.[1] In the 1920's these arguments were frequently repeated. As recently as two years ago the Wyoming legislature memorialized Congress to limit the federal income tax to 25 percent. On the whole, however, the proposition that the federal government retire from the income tax field is no longer earnestly advocated. Our speculation can safely be confined to the fate of the income taxes of the states.

In discussions of the present system of income taxation the proposition is implicit that something is grievously at fault and that the difficulty lies in the simultaneous taxation of personal net incomes by both the federal government and some of the states. In addition to the federal income tax, consisting of a 4 percent normal tax and a surtax imposed at rates ranging from 6 percent to 77 percent, individual net income taxes are also imposed by 31 states and the District of Columbia.[2]

All but three of the state income taxes employ progressive rates. The minimum rates range from 1 to 3 percent; the maximum rates

[1] *First National Conference on State and Local Taxation, Proceedings,* 1907, Macmillan Co., New York, pp. 10, 242.

[2] In addition to the 31 states which levy general income taxes, 4 states tax income from intangibles at flat rates.

from 3 to 15 percent. They apply to net income in excess of personal exemptions which for single individuals are higher than the federal exemptions in 28 states and for married persons in 26 states.

The personal net income tax in its modern forms has been in use by both the federal government and some of the states for almost 30 years. The problem of federal-state income tax coordination has been actively discussed all this time, but so long as tax rates were moderate the issue was of secondary importance. The consequences of conflicting taxation become serious only when the rates involved are severe. When that occurs, the tax inequities and administrative inefficiencies become of real moment and the problem of coordination shifts from the abstract and theoretical to the real and practical.

The question before us is whether in the interest of the general welfare the states must withdraw from the field or whether an integration of the federal and state levies is possible? The question presents itself boldly because the existing lack of coordination is alleged to interfere with the general welfare. The complaints heaped upon it are numerous and weighty.

A major complaint against the existing lack of income tax coordination is that the country is deprived of the most effective use of an important instrument of public policy. The personal income tax has tremendous revenue importance and is a significant influence in such nonfiscal factors as the volume of savings and investments, the behavior of prices and the distribution of wealth. In the interest of the general welfare, so the reasoning runs, the federal government should be free to exploit the income tax without hindrance or delay.

The revenue potentialities of the income tax are of special importance at this time. The present emergency requires a maximum fiscal effort, including the full exploitation of the possibilities of the federal income tax. The existence of state income taxes with widely varying rates interferes with the attainment of that goal. Since the federal government cannot discriminate in its tax rates between the states, the rates it adopts press more heavily on incomes in some states than in others. The heavy taxation of incomes by any one state compels the federal government to burden incomes in states with no income taxes or with lower rate taxes too lightly. In the process the goal of maximum fiscal effort is sacrificed.

In the absence of state income taxes, Congress might conceivably have enacted higher rates for the federal income tax than those recently incorporated in the Revenue Act of 1941. The proposition has some significance but can be overstressed. Much still remains to be done in behalf of the maximum fiscal effort, even if state taxes on incomes remain. It is indeed problematical whether the adoption of the high 1941 rates in advance of the structural revision of the tax base with respect to such items as tax-exempt interest, community property and trust devices, to mention but a few, is in itself

consistent with a maximum fiscal effort. Moreover, the residents of states without income taxes must of necessity supply the revenue requirements of their state governments by paying other taxes, some of which fall at least in part on the same incomes which are called upon to pay income taxes. The discrepancy in burden resulting from variations in state income taxes may be less than is sometimes supposed.

The taxation of income by the federal government and by the states, independently of one another and without regard for the actions or plans of the other, precludes the distribution of the tax burden in conformity with any predetermined pattern. The diverse character of overlapping taxes in different areas is objectionable since they fall unequally on taxpayers with equal taxpaying ability. Special cases of maldistribution of tax burden arise from the uncertainty of taxable situs and the recognition of more than one taxable situs. In the case of nonresident income, some states fail to allow a credit for taxes paid in other states. Where a credit is allowed, the methods of allocation are diverse and in some instances faulty.

In criticism of the existing system, it is also maintained that since the income tax ought to be assessed on the basis of the personal status of the taxpayer, it can best be administered by the government with the widest jurisdiction. It is not suited for state use because income has no local situs. The states' legal tax powers are too limited and their area too small to administer an income tax successfully or to distribute its burden equitably. At that first national conference of this Association, already referred to, the late Professor E. R. A. Seligman expressed the view that "a state income tax would, under our actual American conditions, not work a whit better than the discredited personal property tax, and the only possible resort to it would be under the aegis of the National Government." [3]

It is maintained, too, that the income tax is not suited for state use, because with the present geographic distribution of income, most of its yield will inevitably accrue to a few strategically located states; and that income is a national product and should therefore be a national rather than state source of tax revenue.

On a more commonplace level, the present system is condemned because the resultant multiplicity of tax returns increases the cost of tax administration and thereby the burden on the taxpayer and because it causes needless expense and annoyance to taxpayers. Diverse accounting practices and varying forms of reporting are often required needlessly.

These complaints against the existing system merit careful consideration. Although stated in diverse terms, they tend to point to state withdrawal from the income tax field, or at least, to extensive

[3] *Proceedings*, 1907, p. 507.

centralization in income taxation. This was the conclusion recently reached by the Canadian Royal Commission on Dominion-Provincial Fiscal Relations.[4] This was the conclusion so unceremoniously rejected by some of the Canadian Provinces.

Centralization has many advantages. It holds promise of greater administrative efficiency. Some of its forms can contribute to economy by dispensing with duplicate administrative machinery, by utilizing more specialized personnel, free of local political pressures, by reducing the amount of litigation, and by lessening the burden of taxpayer's compliance growing out of the necessity for multiple records, reports, and tax bills. Some forms of centralization would eliminate competition between states which is wasting the resources of the commonwealth and taxpayer alike. Finally, some forms of centralization would conform to the general trend toward social and economic integration and would enable a better correlation between the revenues required by and the revenues available to the different governments.

These are forceful considerations but much can be said on the other side as well. Centralization is not void of faults and disadvantages. First, it can afford an entering wedge for the abuse of authority. Second, a centralized government would be hard put to recognize the greatly diverse social and economic character of this vast country with its many local differences. Third, decentralization with local participation in local affairs affords a training ground invaluable to good government. Moreover, the greater the decentralization and the more intimate the relationship between the taxpayer, the tax-gatherer and the beneficiary of public spending—the smaller this circle—the keener the sense of financial responsibility. Finally, it is not at all clear that efficiency is entirely on the side of centralization. As government grows beyond a certain point it tends to become increasingly bureaucratic, wasteful and uncoordinated. Huge size tends itself to generate inefficiencies.

This partial list of arguments on both sides of the centralization issue demonstrates its complexity. With specific reference to the tax system no form of centralization so far proposed is fully desirable and totally without fault. The particular brands of centralization advanced for the income tax are well known. It has been suggested that the income tax be federally administered and that this be coupled with either (1) a system of grants-in-aid to the states, or (2) state-sharing of federal revenue or (3) a system of state additions or supplements to the federal tax. The first two would bring important problems of distribution, without an assurance of equating state needs and state revenues; state additions to the federal levy would not remove the diversity of tax burdens among the states.

[4] *Report of the Royal Commission on Dominion-Provincial Relations*, Book II, p. 112.

Some propose that taxes paid to states be allowed as a credit against federal tax liability. Such procedure would not eliminate the waste resulting from duplicate tax administration and duplicate taxpayer's compliance. Whether the crediting device has possibilities outside the death tax and payroll tax fields is itself debatable. In one sense the crediting device is no end in itself, but rather an instrument of transition between independent state levies and an extremely centralized federal levy. When the crediting device produces interstate uniformity and leaves a duplicating administrative organization as the only symbol of states' independence, the process of centralization appears to be nearly complete. So it must appear to the states which desire no income taxes and look upon the crediting device as a disguised form of coercion.

A similar list of reservations can be readily compiled with regard to other brands of centralization. Each in its turn raises the issue of local self-government versus equity and efficiency.

One important factor is the states' stake in income taxation. The 31 states with taxes on personal net income now derive about $300 million of annual revenue from this source. Moreover, they look upon this source as one with great future possibilities. In addition, they have substantial investments in administrative organization and in administrative experience. Those employed in state income tax administration are also involved. If it be true that state governments have already been left with more obligations than they can take care of with their present revenue resources, then the future course of their revenue needs is an important consideration in the appraisal of the states' claim to the personal income tax.

The long-term improvement of the American tax system rests in large part on the effective utilization of the personal income tax. There appears to be general agreement that barring imposts for regulatory purposes and barring taxes for governmental benefits accruing to special groups, the tax burden should be distributed equitably and in accordance with the principle of ability to pay. That principle finds effective application in the selection of income as a major basis of taxation. Time may eventually reveal a more satisfactory basis; one which will take some recognition of subjective as well as objective ability. For the time being, however, income appears to be the most satisfactory criterion available and for that reason should be fully utilized. Tax revision must strive for an income tax sufficiently broad in scope to enable the tapping of taxpaying ability irrespective of the form it takes and to provide that individuals similarly situated will be equally affected.

If this view of the rôle of the income tax is valid, and if it applies to the financing of both the federal and state governments, then means should be found for raising at least part of state requirements through the income tax. Those optimistically inclined may well suggest that in some distant future the income tax will not only be

more important but will go a long way toward providing for the general requirements of state governments as well.

This type of reasoning led the Tax Policy's Committee on the Place of State Income Taxation in the Revenue System of States to go so far as to conclude in its report published in May 1935, that "income taxes should constitute a major source of revenue for state and local governments."

The view conforms also to that of the committee appointed by this Association to prepare a model plan of state and local taxation. I quote from Professor J. W. Martin's interpretation of the report of that committee. "Income taxes are a source of general purpose revenue in perhaps a more fundamental sense than any other tax measure and, since both the federal government and the states require general purpose revenue, it is impossible on logical grounds to segregate income taxes as a proper source either of federal revenue to the exclusion of the States or of state revenue to the exclusion of the federal government." [5]

It can be stated categorically that the further development of the personal income tax is a national necessity. That development may involve a far broader tax than anything now conceived. If that occurs, the attendant problems of administration will be of a magnitude, in comparison with which present administrative problems will seem inconsequential. In such a contingency the existence of a state income tax administration with its decentralized records, experience, and personnel may prove to be very helpful.

A conclusion in favor of the continued retention of the states in the income tax field without too much centralization would not necessarily imply a tolerance of all the present evils. Some of them are in no sense inescapable but spring from a lack of cooperation among the states and between the states and the federal government. They result in jurisdictional conflicts, unequal tax burdens, and the attendant wastefulness and inconvenience to taxpayers. Many of these could be eliminated if machinery were available for interstate negotiations. Some features of federal-state conflicts could be eliminated by the cooperation of the administrative agencies. The reconciliation of unnecessary differences in the tax base, the definition of classes and terms and in the administration of the laws would be a great step forward.

A comparison of the statutory provisions of the federal and state laws indicates a greater degree of uniformity than is generally assumed. The points involved in much of the existing diversity are of little importance to either of the jurisdictions and could be readily eliminated by intergovernmental cooperation. If the development of a common tax return is not in itself at present practicable, much could be accomplished in the direction of relieving the burden of

[5] Interstate Commission on Conflicting Taxation, 1935, *Progress Report*, p. 137.

diverse records now imposed on taxpayers by standardization of statutory concepts and definitions among the states and between the federal government and the states.

In this connection I recall to your attention the report of the Committee of this Association on Fiscal Relations of Federal and State Governments advocating ". . . a more exhaustive study of the possibilities of simplification and coordination to the end that, so far as possible this tax, as separately imposed by state and federal governments, may be upon identical bases. In this way the problem of the taxpayer will be made infinitely simpler and easier; the loss of tax through conflicting provisions and consequent misinterpretation reduced." [6]

This represents a practical approach to the problem and merits more attention than it has hitherto received. At all events, for many states, the income tax is a minor revenue producer and state independence will not stand or fall with it. Moreover, the fate of the income tax will be determined in part by that of the other items in the tax system. The coordination of the income tax is only one step — albeit an important step — in the task of so arranging the finances of the federal, state and local governments as to equalize the revenue needs and the revenue resources of each within the framework of our political institutions.

The tax coordination problems confronting the United States sooner or later confront every federated country. Some of these countries have achieved coordination by sacrificing the principle of federalism itself. The one, however, is not a necessary consequence of the other. Now, as on numerous occasions in the past, the situation calls for compromise. However, the terms of that compromise must be arrived at with great care. The issues involved in centralization permit of no objective analysis. They call for individual judgments, reached anew with respect to each problem as it arises, in the light of prevailing conditions, and on the basis of all the considerations vital not only to federalism but to democracy itself.

We are here specifically concerned with the personal net income tax and find that it involves the self-same issues which have presented themselves periodically since the founding fathers elected to replace the federation by a union of states. Admittedly, the centralization of the personal income tax alone would not in itself seriously alter America's governmental institutions. But much of what has been said in favor of the centralization of the income tax can also be said about the centralization of many other items in the fiscal system. Carried to its logical conclusion, such reasoning can readily lead to the condemnation of the very fundamentals of federation. It is for that reason that each step toward centralization must be taken with caution and only after a careful appraisal of the funda-

[6] *Proceedings of the National Tax Association*, 1934, p. 163.

mentals involved. It is for that reason that the factors involved in the issue whether the states should remain in the income tax field can be more readily stated than appraised.

The present world situation prompts a final word of caution. However attractive the apparent logic of a particular system of coordination, a final judgment of its merits can be made only in terms of our basic institutions. And if that course involves some sacrifice in our present efficiency, it will be well to remember that this nation's vast endowment in earthly goods and services implies an obligation to preserve treasured political institutions even at the expense of some immediate inefficiencies.

Chairman Groves: This program was originally set up in the pattern of a round table, and each of the papers was to be followed by some prepared comments. There are two commentators on this paper by Mr. Ecker-R., one selected from a non-income tax and one from an income tax state, but representing the state point of view as contrasted with Mr. Ecker-R., who is in the federal service. The first commentator, one especially qualified to talk on the subject, is Mr. A. W. Gordon, of the Nebraska Taxpayers Association, of Omaha.

Mr. Gordon.

A. W. Gordon: Gentlemen: When I read Mr. Ecker-R.'s paper, I recognized the futility as well as the fatuity of attempting to add anything to that paper which so excellently presented both sides of the question.

Conceding, for the sake of brevity if for no other reason, that it would be preferable to integrate or coordinate state and federal personal income taxes, there still remains the fact that no matter how sensible and logical a tax procedure may be, its fate lies in the hands of those who are unfortunately more interested in vote-proof shelters than they are in equitable tax laws. Taxation is an economic problem, but is treated as a political one.

Certainly nothing in the last decade would give confidence to the thought that progress in the elimination of the problems arising from conflicting or overlapping taxation is on its way to sane solution.

These problems were present and recognized so keenly that even before President Roosevelt's first inauguration, a call was sent to the governors of the several states to meet in Washington on March 6, 1932 to attempt to find a solution.

Because of ten years of national emergencies that meeting has never been held. Instead, both the federal and local governments have continued to encroach upon tax fields which heretofore have been held to be the proper sphere of the other.

To mention just a few: The federal government now levies a tax upon gasoline, previously a sole field for the states. Sales taxes on a multitude of articles disguised as luxury taxes. As a matter of fact, it has almost levied a poll tax in its recent tax bill when it places a flat tax of $5.00 on every automobile. In turn many states have been forced to adopt the income tax or increase the rates of those already in effect in order to match federal grants-in-aid.

This dilatory messy record does not leave room for confidence that the problems arising from both the state and federal government levying upon personal income tax, will be settled by conferences or agreements.

However, it can be settled by eliminating the states from this field, which in the opinion of many, is a logical proper source for the federal government to preempt in its entirety.

Mr. Ecker-R. has enumerated many reasons supporting this position. I shall not attempt to add to or exploit these thoughts. However, he also presented some reasons against such a procedure, as follows:

First: It can afford an entering wedge for tyranny.

Second: That a centralized government would be hard put to recognize the greatly diverse social and economic local differences.

To me these objections fall of their own weight. Certainly a federal government whose take under present tax bills is approximately 9 billion dollars and whose Secretary of Treasury recently advocated the taking of all profits above 6% and who paraphrased John Paul Jones' famous statement, "We have not yet begun to fight", into, "We have not yet begun to tax", is not going to have its course of action influenced by whether or not the several states are levying a personal income tax which produces only 300 million dollars. Nor have I seen any sign of diffidence on the part of this administration indicating doubt as to its ability to solve all diverse social and economic differences, local, national or international.

Whatever malign powers there may be for tyranny through centralization, exist in the present laws, and will exist in the future tax bills irrespective of whether states do or do not levy personal income taxes.

However, the stake the 31 several states have in the 300 million dollars which they jointly collect merits consideration. I hope I shall not be considered guilty of *lese majeste* if I suggest that in the total expenditure of the 31 states there is the possibility of saving 300 million dollars.

I do not know the total expenditures of these taxes as compared with the 300 million. However, I call attention to this state of Minnesota. Its total expenditures for the state and all of its political subdivisions runs about 270 million a year. Its personal income tax produces about 7 million, approximately 2½%. This in the state

that has the highest personal income tax of any state in the union, and I believe a very low personal exemption.

Certainly as a guest in this state I would be guilty of gross impropriety if I were to suggest that Minnesota is not more than 97½% perfect in its spending, so that no new tax would necessarily be needed. Therefore, I am not suggesting that, but I am sure that all of you gentlemen from different localities will have your own ideas concerning your own states.

I recognize, of course, the advocacy of states retiring from the personal income tax field in favor of the federal government is contrary to the previous resolutions and conclusions of the different committees of this Association in bygone years, and whose findings and deliberations I hold in the highest of respect, but conclusions must be changed with changing conditions.

That is occurring daily in our national government and an income tax field could very easily exist for the states under one federal income tax law, but not be wise under another. Whatever may have been the deliberations, or conclusions of this assembly, the fact remains that the field of income tax revenue is being so rapidly exploited by the federal government that it is approaching the point of diminishing returns both for the state and federal government.

This fact cannot be legislated away. It is more powerful than all state legislatures combined. It is more potent than all of the resolutions passed by conferences sponsored by this Association in 25 years.

Just recently a Washington advisory letter calls attention to the fact that in England the 100% excess profits tax will probably be reduced to 70% in order to increase revenue as well as to increase production.

To the north of us Canada coming to grips with this problem of overlapping taxation, found it necessary to request the provinces to withdraw from the field of income taxation. British Columbia has acceded to the request, and it is predicted that circumstances soon may compel other provinces to follow.

While I cannot conceive of any of our states now employing the personal income tax, pleasantly acquiescing in abandoning this field, I can conceive of the federal government using the power of the grants-in-aid, plus a ruthless use of the income tax to the end that the field of the state income tax will be radically curtailed if not eliminated.

It will not be the first time that state governments have been coerced or coaxed through the voluntary compulsion of grants-in-aid to conform to certain forms of federal regulations.

No matter how avariciously those states now employing the income tax look to its increased use, certainly considerable pause should be given to placing too much reliance on this source.

I am very happy that my own state of Nebraska has as yet not found it necessary to invade this precarious field of revenue. We are not unmindful of the fact that the high income tax of Minnesota and other states affords us a certain measure of protection against federal levies, and we are grateful to these states for their protection.

Yet if, as Mr. Ecker-R. says, the long-term improvement of the American tax system rests in a large part on the effective utilization of the personal income tax, and that utilization is handicapped by the varying rates of the 31 different states, then one of two courses of action seems imperative.

In view of the desperate need of the federal government for revenue to finance its defense program the states should patriotically withdraw from the income tax field and thereby remove the handicap, or else the federal government by *force majeur* should accomplish that which is impossible by cooperation.

To the anguished screams of those states which find this course of action unpalatable, I offer the consolation that cities, counties, and schools as well as states, like individual taxpayers are going to find their standards of living lowered, and they will not be alone in their agony after March 15 next.

Chairman Groves: Thank you, Mr. Gordon.

We have the unusual circumstance, I think, of someone representing the federal government advocating the retention of a revenue source by the states, and someone representing the states advocating its surrender.

I think perhaps we shall get a different point of view from the next commentator, Mr. James P. Truss, Tax Commissioner of the State of Delaware. Mr. Truss.

James P. Truss: Mr. Chairman, Ladies and Gentlemen of the National Tax Conference: Had I not before felt somewhat like a rookie, I certainly, after Mr. Groves presented Mr. Ecker-R.'s paper, and after hearing Mr. Eccles, feel somewhat like the rookie pitcher who was assigned to pitch to Duckie Medwick. He asked his catcher how he should pitch. The catcher said, "You throw the ball, and you run and back up third and I will cover home."

I expect a lot of you state tax people at the present time feel somewhat that way after the announcements that have been made about the elimination of state income taxes. However, in Mr. Ecker-R.'s absence I would like to say that what I am saying in my paper would have been said just the same had he been present.

The principal and most important criticism of this paper is that it does not deal directly with the subject. A great many generalizations are given and platitudes quoted, but we are left in the dark about the place of the state income tax in a period of expanding

federal needs. I must therefore refrain from discussing the issue indicated by the subject, and discuss rather the points brought out in the paper. I shall discuss them seriatim.

First: Mr. Ecker-R. admits only the personal income tax to review. Does this mean that the state corporation income tax has no place?

Second: He states, "The principal point at issue is whether the states should remain in the income tax field." I do not see where the issue comes from—not from the title of the paper. It is important to note that the issue is stated as one of principle, not one of degree. It is not more nor less, but yes or no. He then gives the possible solutions as:

"(1) The states and the federal government might both continue to exploit the field; (2) the states might withdraw and leave the field to the federal government; or (3) the federal government might withdraw and leave the field to the states."

He then dismisses the third possibility, that of the federal government's withdrawing from the field. I should add that the second, that of the states' retirement from the field, should also be eliminated. I can speak for one state and believe 30 others are of the same opinion.

This leaves only one possibility, that the states and federal government might both continue to exploit the field. Shortly after dismissing the third possibility Mr. Ecker-R., in a confusion of the hard, financial facts of taxation with a great deal of pure theory and philosophy strung together in the name of general welfare, says: "The question before us is whether in the interest of the general welfare the states must withdraw from the field or whether an integration of the federal and state levies is possible?"

Since the states are not going to withdraw, we should like to hear Mr. Ecker-R. on the question of integration. I do not think that this audience needs to be convinced that there should be an integration. What we are interested in is how it should be integrated. We are doomed to disappointment when we listen for Mr. Ecker-R.'s ideas on that subject.

Another statement more philosophic than practical is to the effect that "tax revision must strive for an income tax sufficiently broad in scope to enable the tapping of tax-paying ability, irrespective of the form it takes, and to provide that individuals similarly situated will be equally affected." Unless this paper aims at a discussion of pure tax theory and unless you subscribe to this theory many other references are irrelevant to the subject we are considering. What has competition between the states to do with the place of state income taxes in a period of expanding federal fiscal needs? If this be a democracy in which we live, why should anything, including centralization, be "free of local political pressure?" What matter that federal rates press more heavily on incomes in some

states than in others? And what relation does the argument have that "decentralization affords government training grounds?" The paper cites the need for machinery for interstate negotiations. Is this relevant to federal-state relationship?

Let me quote a passage I should not have believed unless I had heard it.

> "A major complaint against the existing lack of income tax coordination is that the country is deprived of the most effective use of an important instrument of public policy. The personal income tax has tremendous revenue importance and is a significant influence in such non-fiscal factors as the volume of savings and investments, the behavior of prices and the distribution of wealth."

Many of us for a long time have thought that the federal income tax rates were very much too high to yield the highest net revenue over any considerable period of time. We could not see why they were kept so high. When we read the 1941 tax bill we thought the treasury officials had lost their minds. Now we know the reason for those rates. It is because the personal income tax rate "is a significant influence in such non-fiscal factors as the volume of savings and investment, the behavior of prices and the distribution of wealth."

Let us see the significance of these non-fiscal factors. High rates can do no other than reduce savings and investment, and by that means lower production facilities. The result is lower wages and higher prices. I take it that his phrase "distribution of wealth" means reduction in the unequal distribution of wealth, for "non-fiscal factors" can mean nothing else. The effect, as I have just pointed out, of those high rates is to make us all poorer, but I do not think they influence the relative distribution of wealth.

Mr. Ecker-R. says the existence of the state rates hampers the fiscal policy of the federal government, implying that if the states had no rates the federal rate could be set higher. I do not believe that higher rates would yield any more money. One of the things that it is important to learn in taxation is that two and two do not always make four. They sometimes make three or two or one.

One word more as to the charge made in the paper that state income taxes interfere with the maximum fiscal effort. Little or no evidence is available that the Treasury Department weighed the impact of state income taxes upon the federal rates in drafting the 1941 legislation. The representatives of a number of states have been sufficiently interested in the impact of federal rates upon state income taxes, however, to meet in conference and present a request to the Senate Finance Committee that they be permitted to be heard before the next draft is presented for enactment.

Statements as to the effective utilization of income tax to create some social and economic integration and its characterization as "an instrument of public policy" have little bearing upon the employment of this form of taxation by the several states, and should have no bearing upon its employment by federal government.

Mr. Ecker-R. speaks of a structural revision of the federal income tax, mentioned the subject of tax-exempt interest, community property and trust devices. Taking these up seriatim, I do not believe that the tax-exempt securities are nearly as important as many people think. First, the interest rate on those securities is exceedingly low. Second, they are held, on account of their liquidity, very largely by financial institutions which are not reached by the personal income tax. The elimination of the community property provision, if it could be done legally, would not add, percentage wise, much income. The trust device is the child of higher rates.

Mr. Ecker-R. then proceeds to read the states out of income tax field altogether, saying that "In criticism of the existing system, it is also maintained that since the income tax ought to be assessed on the basis of the personal status of the taxpayer, it can best be administered by the government with the widest jurisdiction. It is not suited for state use because income has no local situs."

Income has an international, national, and state situs. The situs of the taxable is the situs of the income.

"The states' legal tax powers are too limited and their area too small to administer an income tax successfully or to equalize its burden equitably." This statement admits of no more or less. It reads the states entirely out of the field.

"At that first national conference of this Association, already referred to, the late Professor E. R. A. Seligman expressed the view that 'a State income tax would, under our actual American conditions, not work a whit better than the discredited personal property tax, and the only possible resort to it would be under the aegis of the National Government.'" If I were to quote Professor Seligman's statement made in 1907 in this connection, I would do so to ridicule him, for it does nothing but show how wrong an eminent professor can be. I do not know what Mr. Ecker-R. is trying to prove by the quotation, but if it is that the state income tax is now administered no better than was the personal property tax in 1907, he is inconsistent with the remainder of his paper, for the implication there is that it is successfully administered. In fact, his chief kick seems to be that the state income tax cramps the style of the Treasury. If it were not better administered than the personal property tax, the Treasury could ignore it.

Again in discussing the geographical distribution of income, by which I think he means geographical concentration of the large income recipients, he reads the state out of the field. This may be correct if the states were the only levels of government collecting

the tax that he eliminated in the first part of his paper. Again it is a question of yes or no, not more or less.

On the score of multiplicity of tax returns, annoyance to taxpayers, etc., it seems to me that those annoyances are made too much of. The extra state expenditures for income tax collections are not much. The great similarities of state and federal laws and procedures reduce the accounting, etc., to very little more than one accounting would cost the taxable. Is it impossible to remedy most of those difficulties?

That the dual system of collecting personal income taxes results in increased costs and administrative imperfection is of no real moment until our tax rates for the present fiscal effort reach down to the subsistence level. To strain to make argument of such costs seems ludicrous to us in Delaware when we couple our thinking on costs with non-defense expenditures which are being met out of federal taxation.

It is impossible to think of revenue without thinking of expenditures and this relates the argument to expanding federal needs, the federal budget, either including or excluding the maximum fiscal effort for defense. A suggestion seems in point—that coordination within the federal government itself of its revenue sources with its budget-making functions might remove some of the pressure for continually mounting personal income taxes. Public finance is concerned more with this type of coordination than with theories or rationalizations.

On this point Mr. Ecker-R. recognizes the dollar-and-cents economies which can be effected by a smaller circle local government.

"Finally, some forms of centralization would conform to the general trend toward social and economic integration and would enable a better correlation between the revenues required by and the revenues available to the different governments." One is prompted to ask how many forms of centralization there are. In a paper read by Dr. Gerhard Colm before this Association in 1939, he stated that the prevailing idea of taxation in Europe was to motivate economic changes. This is, to my mind, just what we do not want in the United States.

When considering the advantages of decentralization of tax administration, Mr. Ecker-R. pays lip service to the recognized platitudes, all of which we are familiar with.

> "It has been suggested that the income tax be federally administered and that this be coupled with either (1) a system of grants-in-aid to the states, or (2) state-sharing of the federal revenue, or (3) a system of state additions or supplements to the federal tax. The first two would bring important problems of distribution, without an assurance of equating state needs and state revenues; state additions to the federal levy would not remove the diversity of tax burdens among the states."

In the above quotation, together with his statement on the crediting device discussed in his next paragraph, Mr. Ecker-R. administers the coup-de-grace. We people in the state tax administrative field should be grateful for Mr. Ecker-R.'s solicitude of our welfare should the federal government take over the income tax field. But be not alarmed, for if the federal government intends to exploit the field as fully as he intimates, it will need a lot of experienced hands.

In the last two paragraphs Mr. Ecker-R., after having read the states out of the income tax field altogether, concludes that the real justification for the states' staying in the field is to prevent any step, however unimportant, being taken to break down our federalized system of government. Put most bluntly, he does add a word of caution in warning us that centralization is going to be effected but should be proceeded with gradually lest our treasured political institutions be destroyed. It would be very interesting to foresee and foretell how this is to be done unless our treasured political institutions are to be preserved in a museum and gather dust until we are some day forced to return to them with all the benefits of local self-government which have preserved this country and probably democracy, call the form federation, or union, or what you will.

He does not enlighten us on "The Place of the State Income Tax in a Period of Expanding Federal Needs."

Chairman Groves: I think there are a great many people here who would like to join in this discussion, and I hope that may be possible; but, as you will observe from the program, the general discussion will be at the end of the papers.

Outside of the question of the place of the income tax in the future, a great many other aspects of the state income tax that are of interest have been placed on the program. One deals with the administration of the tax and the other with the all-important problem of allocation.

The paper on the administration of the income tax will be read by a student of the subject who undertook as a means of research to use an automobile and a suitcase—that is, he went to all of the income tax states, with one or two exceptions, I believe, and really stayed long enough in those states to learn what was going on. Consequently, he has an unusual perspective on the problems and methods in state income tax administration.

It is now my pleasure to introduce Dr. Walter W. Heller, of the University of Wisconsin.

Walter W. Heller: Mr. Chairman, Ladies and Gentlemen of the Conference: Before tackling the specific problems which are the subject of my paper this afternoon, I should like to record one or two general impressions of state income tax administration. As Professor Groves stated, I spent the better part of a year roaming

at large in state income tax states and provinces. In fact, I missed but one state; that was South Carolina. That was not an omission with malice aforethought. It just happened that the choice lay between Tennessee and South Carolina, and the Great Smoky Mountains lay in between, so I missed South Carolina.

State income taxation has come a long way since 1911, when Wisconsin introduced the first successful state income tax. In fact, I think it is safe to say that the minimum level of administration today is well above the maximum level of administration prior to 1911. Chiefly responsible for the improvement are perhaps three things: first, centralization of authority; second, the use of the information-at-source device; and, third, improvements in personnel.

But the state income tax still falls considerably short of early expectations, and administration is at least partially responsible. In a few states we still have what one administrator termed "catch-as-catch-can administration," and, in general, states suffer from limitations of appropriations and staff. If one were to select the factor which determines good or bad administration, that factor would be the obvious one of personnel. In fact, the problem of personnel is the most pervasive one in the field of state income taxation. That is one of the problems that the ensuing discussion will not deal with.

SELECTED PROBLEMS IN STATE INCOME TAX ADMINISTRATION *

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Rather than attempt to enumerate state practices on a wide range of points, this discussion directs itself to three problems on the frontiers of state income tax administration. The first is that of administrative integration with other taxes. What benefits does current state practice lead us to expect from this measure? Second, the problem of administering income taxes in the lower brackets. Does previous state experience support broadening of state income tax bases? Does it indicate that the federal excursion into the lower income strata will be an administrative success? Third, the problem of state-federal cooperation. How far has it advanced? What further advances seem appropriate under duress of mounting fiscal pressures? Upon the disposition of these problems depends much of the future of state income taxation.

ADMINISTRATIVE INTEGRATION

In contrast with consolidation, which merely houses a number of different taxes under a single administrative roof, integration im-

* Acknowledgment is due the Social Science Research Council whose fellowship grant made possible the field research in American states and Canadian provinces which underlies this paper.

plies a marital relationship between taxes. In an integrated structure, administration of related taxes is so tightly interwoven that each lends support to the others. Administering units are organized along functional lines which deny any one tax the privilege of an isolated existence.

Only a few income tax states have thus far adopted integrated structures. Perhaps the most thoroughgoing is Utah, which has replaced the traditional tax divisions with a series of functional units, one for auditing, another for collections, a third for legal work, and so forth. Tax lines are ignored insofar as each unit discharges its particular function for all taxes. Kentucky, Delaware, and North Carolina have similarly, if not so thoroughly, interwoven income and other taxes. A few other states integrate the performance of selected functions, primarily field activities, for several taxes. But two-thirds of the 35 income tax states cling to a strict tax-by-tax structure, in which each division concerns itself with one tax and no other.

Doubts are cast on such separatism by the demonstrated advantages of interlocking administration. First of all, many taxes achieve full stature only through association with other taxes. Take, for example, such complementary taxes as those on income, inheritances, and gifts.

Each is a vital source of information for the others. Death tax returns may be used by income tax officials to verify property incomes previously reported by the decedent, fees reported by attorneys and executors, and appraisal values which serve as capital gain and loss bases on inherited property. Income returns reciprocate by providing an excellent index of the size and composition of a decedent's estate, and by furnishing information on ownership of bearer securities and other elusive holdings.

But even more important, there are many "either-or" tax situations over which the administrator cannot have full control short of integrated authority. If the claim is made that certain property is not subject to death taxes because of a transfer during life-time for services rendered, the tax agent should be able to counter with, "In that case, we'll have to tax it as income to the recipient." Likewise, only if reins of authority for both taxes are in single hands can reporting of attorneys' and administrators' fees as income be made a prerequisite to their allowance as death tax deductions. And where the income tax auditor finds stocks or an interest in a business being sold below actual market value, he should be able to step in and apply the proper gift taxes to the lucky buyer. Further points of contact need not be enumerated to establish the case for integration of these taxes. The strength of amalgamated administration of income, gift, and death taxes is clearly greater than the sum of the strengths of the three administered separately.

Automatic interchange of tax information and maximum effectiveness in administering interrelated taxes are benefits that all states may derive from integration. But small and sparsely populated states have an additional stake in unitary administration of their several taxes. The 14 states which employ less than 25 persons to administer their income taxes are a case in point. With so small a staff, technical specialization is difficult and the proper decentralization of taxpayer services almost impossible. Personnel concentrate on one *tax*, it is true, but the work volume is insufficient to let them concentrate on one *task*. And the job of administering the income tax alone is simply not big enough to permit the creation of positions of sufficient prestige and salary to attract first-rate personnel. Yet, we find that Utah, with a population of only half a million spread over a wide area, has developed real specialists in tax auditing, has established branch offices in several cities, and ranks high among the income tax states in its salary levels. Such are the blessings of integration!

Improved coverage, compliance, and convenience are the promise it holds for states both large and small. And for the latter it is also the condition precedent to (a) creation of positions attractive to personnel of high calibre; (b) provision of adequate field services; and (c) realization of the economies of scale.

In view of the usual legislative refusal to appropriate sufficient funds for administration, tax departments can extend their horizons mainly by stretching the dollars they have. One of the best stretching tools at their command is integration.

THE TAXATION OF SMALL INCOMES

Although it is customary to turn to Europe, Australia, and other remote parts of the world for information on the feasibility of taxing small incomes, a substantial reservoir of experience exists within the bounds of our own states. Since decisions to tap the lower income brackets revolve around the question of administration and since states taxing small incomes have been dealing with the same raw materials that current and proposed tax programs must utilize, it becomes of interest to find out how the state pioneers in lower-bracket taxation have fared.

Delaware provides perhaps the most illuminating experience of all, one which is unique in at least two respects. First, it involves the superimposing of an extremely low-bracket county tax on a state tax which had been operating for more than a decade. Second, the set-up of the county tax was such that incremental revenues and costs of this trail-blazing venture into the lower income strata can be isolated and appraised.

The facts were briefly these: the state tax, then as now, provided exemptions of $2,000 for married persons, $1,000 for single persons, and $200 for dependents, and every able-bodied person over the

age of 21 was required to file a return. Rates were 1 percent on the first \$3,000, 2 percent on the next \$7,000 and 3 percent on all over \$10,000 of net taxable income. A tax strictly paralleling the state measure except in exemptions, was enacted for New Castle County, which regularly produces over 95 percent of the Delaware state income tax revenue. On 1934 incomes, the county tax exemptions were \$1,000 for married persons, zero for single persons, and \$100 for dependents. The incremental revenue produced by these exemption-cuts amounted to \$180,884, or 23.2 percent more than the amount realized by the state under its higher exemptions.[1] This increase was achieved despite low rates and the great concentration of Delaware taxable income in the hands of a few upper-bracket individuals.

Although the state administered the county tax, a separate county expense fund was set up. Incremental costs that could be attributed to the addition of the county tax were charged against this fund. These costs aggregated \$21,676, or but 2.3 percent of the total of \$960,782 produced by the county tax. To get a maximum figure for percentage costs incurred in taxing small incomes, we can allocate the entire cost to the 23 percent increment in revenue produced by the reduction in exemptions. The resultant cost figure is but 12 percent. If, as seems reasonable, \$5,000 or more of the \$21,676 would have been spent for administration of the separate county tax even without the exemption cuts, it is safe to conclude that the cost of applying the tax to married persons' incomes between \$1,000 and \$2,000 and to single persons' incomes between zero and \$1,000 was less than 10 percent.

The existence of Delaware's universal filing requirement was very important to the success of the low-bracket county tax. But both the accompanying provision for at-source reports on all income payments over \$100 and the administrative device of a door-to-door canvass contributed to completeness of taxpayer and income coverage.

Revenues, costs, and administrators' opinions all attest to the administrative success of the Delaware experiment. Delaware Tax Commissioner James P. Truss concluded from his state's experience:

> ". . . we limited evasion largely to single individuals with incomes less than \$500 or \$400. In view of our Delaware experience, I believe that exemptions of \$500 and \$1,000, or, surely, exemptions of \$600 and \$1,200, can be applied if it is considered good fiscal policy to enact them."[2]

[1] The figures for Delaware are taken from the 1936 report of the Delaware Tax Commissioner.

[2] Statement made to writer during interview in April 1940.

Most instructive among the experiences of other states has been that of Utah, the only state whose entire exemption schedule remains below the new federal limits. Although it abandoned a universal filing requirement because of administrative difficulties, it has retained personal exemptions of $600, $1,200 and $300. Like Delaware, its rates are low. Yet, within the bounds of reasonable administrative costs—which Utah's sound cost allocation system show as averaging around 5 percent of total collections—Utah has demonstrated the workability of a small incomes tax in a poor and sparsely settled state.

What informational sources has it found particularly helpful in gaining compliance among the lower income groups? Integration has facilitated the use of inheritance tax and sales tax returns, property tax rolls, and license tax records. Among the other governmental resources that have been exploited are unemployment compensation data, lists of physicians and dentists in the office of the state department of registration, real estate transfer files, and records of the banking, insurance, and public service commissions. Each yields information on potential taxpayers or on probable income and all supplement such standard sources as information returns and federal returns.

A questionnaire form of return—along the lines suggested by Senator Walsh of Massachusetts in the recent hearings on the 1941 Revenue Act [3]—is a device used with singular success by Utah. Taxpayers in lower brackets who may be unwilling or unable to tackle a complicated tax return are given the option of answering a simply-worded questionnaire designed to reveal their tax status. Thousands of new filers have been added through use of this device.

An unusual attitude toward the lower bracket taxation is reflected in the following comment by the chief auditor of the Utah Tax Commission, Mr. W. W. Dansie:

> "Out here, we have to get into the lower brackets to get revenue and to make the income tax justifiable from the standpoint of administrative cost. Our larger coverage means a lower cost per return, since the variable cost per return does not increase as fast as the fixed cost per return decreases. We have to go into the lower brackets to justify the cost of collection of our revenues." [4]

Several other states have adopted exemptions either lower than, or approximately equal to, the new federal figures of $750 and $1,500. Among these, Oregon and Wisconsin have been conspicuously successful; and Idaho, Kansas, and North Dakota have seen

[3] See *Hearings before the Committee on Finance*, U. S. Senate, on H. R. 5417 (Revenue Act of 1941), p. 26.

[4] Statement made to writer during interview in July 1940.

fit to retain low exemptions; but Iowa, South Dakota, and West Virginia, formerly in the small incomes area, have retreated to higher income strata, at least partially for administrative reasons.

Nonetheless, this conclusion stands: given good administration and adequate appropriations, the income tax can successfully reach into the very low income classes. State experience suggests (1) that the establishment of a broad base of taxpayer filing—characteristic of Delaware, Oregon, Utah, and Wisconsin—is good insurance for success in downward extension of exemptions; (2) that techniques for attainment of adequate income and taxpayer coverage are available; and (3) that costs of gaining compliance in income brackets as low as $500 for single persons and $1,000 for married persons need not be prohibitive.

What answers does state experience provide to the questions posed at the outset? First, the success of lower-bracket taxation in states which can hardly be called fertile ground for taxation of small incomes—in terms of population density and coverage of the information-at-source system—augurs well for future decreases in exemptions, especially in industrialized states. Second, the federal agency, with both jurisdictional and staff superiority over the states, and a more fertile income field on the average than that of the states discussed, has at its command the objective elements essential to success in its new venture. To assure that success, however, the Bureau of Internal Revenue will have to modify its traditional preoccupation with large-income returns and bring its vast resources to bear on the problem of taxing small incomes. These conclusions are reached without assuming the development of new administrative instruments. If, however, presumptive or indiciary methods of determining small business, professional, and farm incomes are developed and collection at source is applied to wages, interest, and dividends, the administrative limits to downward extension of income taxes become quite remote.

FEDERAL-STATE COOPERATION

One of the most significant developments of recent years in state income taxation has been the increased cooperation between state and federal administrations. Largely unilateral in favor of the states, it has taken the form of state inspection of federal returns and audit results and related state use of federal data. This one-sided relationship is largely as it should be in view of the balance of administrative advantages that the federal government can safely claim.

No state has at its command administrative resources comparable to those of the Bureau of Internal Revenue. The latter's superiority stems from (1) inherently broader jurisdiction, which gives it access to more complete information at source; (2) greater remoteness, which renders it more aloof to taxpayer (political) pressures:

(3) statutory provision of more adequate appropriations and staff; and (4) advantages of size in the form of greater specialization and consequent expertness in technical phases of the income tax. Free flow of federal administrative results to the states can do much to overcome the handicaps of limited jurisdiction, funds, and staff.

Although the state stake in cooperation is clearly greater than the federal, the recent reduction in federal exemptions has provided a better basis for reciprocity. For, while the federal agency's technical excellence cannot be matched by the states, yet the latter have in many cases developed compliance activities and information sources which the federal agency, in its emphasis on the higher brackets, has not sufficiently explored. And many state and local government sources of information, which should be exploited to support a program of lower-bracket taxation, are not ordinarily open to federal agents. Hence, the states are now in a position to offer at least partially reciprocal benefits to the Bureau of Internal Revenue.

But even if neither unit had concrete advantages over the other in certain sectors of administration, the potential gain from cooperation would still be great. For a meshing of state into federal activities would mean the elimination of duplication which at present inflates administrative and compliance costs and impairs the prime asset of taxpayer goodwill. The ends of administrative economy and taxpayer convenience are clearly served by joint action.

Steps in the direction of placing superior federal resources at the disposal of the states, and incidentally eliminating some duplication of effort, have been taken. Under terms of the much-publicized Costigan Amendment and other equally important statutes and regulations, green duplicates (now discontinued) and originals of federal returns have been made available to income tax states.[5] The great majority of states made use of the green copies and at least 11 states—Arizona, Georgia, Kansas, Massachusetts, Missouri, New Hampshire, New Mexico, New York, North Carolina, Oregon, and Virginia—have sent their employees to Washington to transcribe or micro-photograph original federal returns. And all but two or three states intermittently request and receive photostatic copies of federal returns for specified taxpayers.

But the most important federal service—and one that marks the farthest advance to date of the tide of federal-state cooperation in income taxation—is the automatic transcript service. Through it some 25 states are now sharing in the fruits of the federal audit program. Audit results are automatically transmitted by a special section in the Bureau of Internal Revenue to those states that have taken advantage of this really remarkable service. State use of such information ranges from that in Wisconsin, which derives leads for

[5] See U. S. Bureau of Internal Revenue Regulations 103, Section 19.55b.

its own field auditing from the federal transcripts, to that in West Virginia, where abstracted federal audits virtually serve as a substitute for a state field audit program.

Great though these advances along the federal-state cooperative front may be, the question arises whether they are great enough to satisfy the demands of the times. As the fiscal pressures of defense are intensified, it becomes imperative to minimize frictions in raising revenue and to promote the optimum use of administrative resources. Only by providing true integration on a second plane, viz., intergovernmentally, can these requirements be fully met. The elimination of costly duplication and interstate and federal-state conflicts and the full transmission of federal advantages to the states can best be served by federalized administration.

Canada has successfully dominionized the administration of the provincial income taxes of Manitoba, Ontario, and Prince Edward Island. Only one return is made out for both provincial and dominion purposes, yet each province has retained independent rates, independent exemptions, and even some differences in income definition. The dominion furnishes administration to the provinces for a mere two percent, or less, of collections. This plan could be admirably tailored to suit the needs of the United States.

A concrete program of action might set as its first objective the establishment of an agency—a commission perhaps—to work out a plan for federalized administration and to serve as a liaison between the Bureau of Internal Revenue and interested state governments. The possibilities of a limited federal credit similar to that for death taxes might also be considered. This credit could be made conditional upon (1) adoption of a state law in substantial conformity with the federal in income definition and (2) acceptance of federal administration. The federal credit would here play an unfamiliar role, viz., that of an instrument to promote intergovernmental integration in the sphere of tax administration. Space limitations prevent discussion at this point of the many fiscal, constitutional, and operational implications of the suggested plan. But the credit plan could very probably be so drawn as to achieve the objectives of federal-state administrative integration and yet preserve that state autonomy in rates and exemptions which is vital to maintenance of (a) state control of its own purse strings and (b) certain fundamental values of self-government.

Many people eye with suspicion such far-reaching plans for federal-state integration. They fear that it means eventual absorption by the federal government of state income taxes. But, seen in a different and perhaps more realistic light, such integration is in essence a protective measure. For by fitting their income taxes into an integrated scheme, the states can prevent a war-pressed federal government from effectively preempting the income tax field. Granted the traditional tenacity of American government institutions, the

fiscal "wave of the future" may nonetheless wipe out state income taxes unless firm federal-state bridges are built.

CHAIRMAN GROVES: I think you will all agree that that was a very meaty paper.

We have two comments concerning this paper on state income tax administration. The first is by the director of the income tax division, Minnesota Department of Taxation, Mr. William G. Burkman.

WILLIAM G. BURKMAN: Mr. Chairman and Members of the National Tax Conference:

I am scheduled on the program to discuss Mr. Heller's paper entitled "Selected Problems In State Income Tax Administration" which he was commissioned to draft by the Social Science Research Council.

We, the Minnesota Department of Taxation, had the pleasure of working with Mr. Heller for about a week last year during the course of his field research program to secure source material for his paper. He worked with the head of our individual audit section, our statistical section, our corporation audit section, the conferee and reviewing section, and we were impressed by the copious notes he took on our procedure, progress, and problems.

Of recent years the income tax has become a favorite of most state legislatures and its rapid growth has brought about many problems.

Mr. Heller's paper indicates that he made a comprehensive study of the subject. However, we are unable to agree with some of his conclusions. It should be noted that the views stated here are my personal views and not the viewpoints of the Minnesota Department of Taxation. Mr. Heller's paper deals with three major points. No comments are made with respect to his second point; that is, the taxation of small incomes as this problem has been given thorough consideration by our state legislature. As to his first point, there is undoubtedly something to be said for administrative integration. However, the field of taxation, and especially of income taxation, is admittedly becoming more and more specialized. The courts of the country abound with income tax litigation. It necessarily follows that the more specialized training and experience an income tax examiner has, the better the administration of the income tax act will be. We believe this is true also with respect to other taxes.

We have had less than a week to consider Mr. Heller's viewpoint as expressed in this paper on integration but it seems that he is attempting to extract a rule taken from the experiences of the smaller, more sparsely settled states which should not condition the effectiveness of the administration in the larger states. We find the percentage of income taxpayers whose net income computations are affected repeatedly by inheritance and gift tax matters represent

a very small percentage of individual taxpayers as a whole. It is perfectly obvious that corporate income personnel would rarely, if ever, have to resort to gift and inheritance tax department data during the course of auditing these corporation returns.

In Minnesota we find that it would be most disadvantageous to expect an individual return examiner to work effectively as a corporation income tax examiner. We find that we must have personnel identified solely with corporation matters as well as other examiners identified with solely individual matters and neither can be expected to work effectively on the problems encountered by the other. We find that even within the corporation and individual auditing sections we have specialists who work on certain classes of returns. Some are lawyers, some are accountants, some are both, some have an aptitude of special investigation while others can work to a better advantage on a general routine audit. If we find it advantageous to restrict activities of personnel to corporation or individual taxpayers' returns and then to classes of returns within those sections we fail to see how we could expect the same men to be thoroughly familiar with inheritance tax laws, gift tax laws, social security laws, etc., so that they could work effectively on the audit problems encountered in all of these various taxes.

We find that Mr. Heller, in his paper, has not given cognizance to corporation tax problems whatever. The words "corporate taxpayer" do not appear in the paper and everyone is in accord that corporate income tax revenues are a major factor in the income taxes of nearly every state.

I now turn to the third major problem covered by Mr. Heller. That is, federal-state cooperation. Mr. Heller's conclusion is phrased in the following words: "The elimination of costly duplication and interstate and federal-state conflicts and the full transmision of the blessings of federal superiority to the states can best be served by federalized administration."

My experience as a tax administrator, which dates practically to the basic date of the Minnesota income tax act, dictates that before that Utopia can be realized a great many principles of state sovereignty will have to be abandoned. Our legislature has enacted its income tax laws to meet certain of its fiscal needs. It is difficult to appreciate how the objective of our legislature can be met by employees who are accountable to a different legislative body. The framers of our American constitutional form of government had in mind a new order which would not jeopardize an independent and local control of taxation policies.

We believe that a state cannot relinquish control of its state income tax administration any more than it can any other state function; such as, administration of gift and inheritance tax laws, the administration and supervision of public utilities by the Railroad and Warehouse Commission, the administration of the gross earn-

ings tax against railroads, express companies, sleeping car companies, telephone companies, insurance companies, etc.; the administration of the taxes on gasoline and related products, the administration of sales taxes in the states having such laws; the administration of taxes imposed against the iron ore companies operating in northern Minnesota, the substitution of the Federal Bureau of Investigation for local policing powers, and many other functions. Just because we may be able to find a theoretical justification for federal administration of state income tax laws we are not necessarily going to find state legislatures willing to relinquish any of their aspects of sovereignty.

Minnesota income tax receipts approximate $12,500,000 annually; the total state budget approaches $180,000,000. It will be observed that income tax receipts are relatively small in terms of state fiscal needs.

The concept of complete sovereignty with respect to the administration of taxes within its jurisdiction might be jeopardized merely because of an anticipated administrative expediency with respect to a very small portion of state collections.

If there is one problem that is peculiar to state income taxation it is the problem of allocation of taxable income of individual, partnership, fiduciary and corporate taxpayers. Nowhere does Mr. Heller indicate how he would cope with this problem. This phase of the administration of income tax laws presents numerous difficult problems with respect to individual and partnership taxpayers which must be determined. However, the problem becomes acute in determining corporate tax liabilities. The various state income tax statutes at present have various methods of dealing with the problem of allocation. There is truly a constitutional question presented in this problem which cannot be solved merely by granting away the administrative power to the federal government.

In closing I wish to revert to the first point considered by Mr. Heller; that is, the administrative integration of all state taxes into one central enforcement body. We are unable to reconcile his conclusion on this point with his conclusion as to the federal-state cooperation. On one hand he advances the theory that all state taxing laws should have a centralized integrated enforcement body. This theory necessarily contemplates state administration. On the other hand, he says that Washington should enforce all state income tax laws. The two conclusions appear to be irreconcilable. It is apparent that if you have one you cannot have the other.

Chairman Groves: Thank you, Mr. Burkman. It seems to be quite possible to get a difference of opinion even on the subject of administration.

The next comment will be by Mr. L. C. Burns, supervisor, the Income Tax Department, Montana Board of Equalization.

L. C. Burns: Mr. Chairman, Ladies and Gentlemen of the Assembly: I hesitate very seriously to challenge any of the remarks made by Dr. Heller. It wasn't until just now that I learned he had such a broad scope of survey, and undoubtedly this survey has given him an opportunity to study conditions in other jurisdictions far beyond my knowledge.

Professor Heller brings before our vision in bold relief three problems on which much of the future of state income taxation depends: administrative integration, taxation of small incomes, and federal-state cooperation.

There are few guide posts along the way to complete integration of state revenue laws. Most all state revenue measures have been pieced together by one legislature after another as the need for new funds developed. Professor Heller's conclusions on this question are sound. Every state should experience a reorganization process from time to time and sift the revenue-producing measures down through one funnel so that they would fall into the hands of one administrative body. Appropriations for the operation of this administrative function should not be limited to a specific expense. The administrator should be left free to inaugurate processes for expediency's sake and not be handicapped by appropriation restrictions.

Dr. Heller suggests that in some states, Utah, Kentucky, Delaware and North Carolina, this integration has been perfected in a measure, while in a few other states consolidation has taken place only in the field service. In Montana, this condition is somewhat the reverse. Most of the revenue-bearing measures with distinct appropriations have been dumped into the lap of the State Board of Equalization. The board has thus been compelled to set up several separate administrative units.

As each new tax law is adopted the board usually selects some seasoned member, or members of its staff to compose the new unit and promotes others to more responsible positions, recruiting new employees to take their places at the bottom of the ladder.

The work conducted by these separate units is completely coordinated so that all information has a free flow from one unit to the other. This includes inheritance tax, natural resource taxes of various kinds, income tax, corporation tax and gasoline tax.

Most field men of other departments, other than the income tax department, have at some time been engaged in income tax work and are familiar with Commerce Clearing House and Prentice Hall services.

During the rush of the income tax filing period they are transferred to the payroll of the income tax department and serve throughout the drive. So to that extent we have accomplished integration of the field service without a consolidation of taxing statutes.

The new federal income tax law with its lower exemptions and higher rates will validate or explode the economic theories of two

schools of thought. One school has advocated the broad base and low rates, as compared to the narrow base and high rates. We should soon learn the results of this abrupt change in our tax system.

The experience of the few states operating under low exemptions together with low rates, is hardly sufficient to give us a clear picture of the taxpayer's reaction. This taxpayer reaction is the unknown factor. The present day increase in living costs combined with the bold effort which taxpayers are making to educate their families makes it difficult for those in the lower income brackets to meet their tax burden. Cooperation is essential to successful administration. Without this the law must fail.

I desire to cast just a few lights and shadows on events which will transpire in every collector's office in the United States as we dig down deeper into the barrel. Instead of 90 percent of the taxable returns being fully paid at the time the return is filed and the account closed as the assessment list is posted 33⅓ percent will be fully paid and the other 66⅔ percent will be paid on the installment plan. These outstanding accounts set into motion expensive machinery in preparing and mailing out notices June 15, September 15, and December 15.

Seventy-five percent of the June installments will be paid and 25 percent will lapse into delinquency, thus setting into motion new machinery involving warrant for distraint proceedings.

These warrants will find their way into the hands of the field men who will make personal calls, some of which will require several follow-up calls before collection is accomplished.

The lapses in September and December will exceed those of June —all of which involve the same processes. Anyone who knows anything about travel expense and salary costs can see how quickly the small accounts can be absorbed 100 percent or more in collection processes.

This is only a part of the picture. The payment of tax by those in the lower income tax brackets is hard. Many will not have the money with which to pay the tax at the time the return should be filed and will thus neglect to file returns at all.

Thus the collector will find after a long and expensive search of his file that he has a large list of delinquent taxpayers to solicit. Delinquent taxpayers lose the installment privilege and must pay the entire amount. This sets in motion another set of machinery much of which will involve personal calls on the taxpayer by field examiners.

Now these figures may be exaggerated but they illustrate the point which Professor Blakey made in his article in the April issue, *Taxes*, page 232, when he said "Small exemptions increase administration work more than is justified by increase in yield".

Professor Fred R. Fairchild during the course of his discussion before this assembly in 1937 made the following statement: "New

taxes—such as the income tax—have been introduced and, in their turn, pushed close to the limit of elasticity for efficient administration." It is not difficult to forecast the ultimate results if the states adopted rates and exemptions paralleling those of the present federal income tax law.

The question might well be raised, "Is the federal government gradually crowding the states out of the income tax field"?

I am inclined to believe that Professor Heller has the wrong conception of federal and state cooperation.

Under the provisions of Section 3631, *Internal Revenue Code,* collectors of internal revenue are given broad authority in their quest for taxes. Montana has always taken the position, in spite of the confidential clause in its law, that this authority included inspection of state income tax records. The development of income tax systems by states increased the necessity for authority by states to examine federal records. Thus Section 55 was broadened to accommodate state tax administrators. The Bureau of Internal Revenue has vitalized the law to the full extent of its authority. I believe that this broadening process took place in 1937. Section 55, as I recall, mentions no reciprocity feature. Thus, Professor Heller's reference to a one-sided relationship in favor of the state administrators is in error and the lowering of federal personal exemption neither adds to or takes away any federal rights to examine state records.

We have not been convinced that transcripts of all federal income tax returns were profitable. State administrators who take full advantage of their rights to examine records in collectors' offices, in combination with the bureau transcript service in Washington, can usually detect most of the flagrant errors and omissions without the expensive process of coordinating all federal transcripts with state returns. Moreover, the judicious use of these federal records by state administrators will substantially reduce the cost of state administration. Section 55 was broadened for that specific purpose and no other. After all, whose tax dollar pays the bureau salary and expense for the conduct of these examinations and records? The frugal citizen taxpayer should view this cooperative service with favor. As deputy commissioner of internal revenue, Sherwood, in his remarks before this assembly, pointed out, ethical use of the information should be exercised by state administrators. I say to you that administrators who neglect to make use of this service are derelict of duty.

Professor Heller finally suggests that the crowning feature of perfect cooperation is complete integration. No perfect tax system has yet been devised. We have no assurance that the merging of these two systems would materially reduce our present difficulties; nor do we know that the administrative costs would be materially

reduced. We are convinced that the quality of the administration would be improved.

For several years, the government has been systematically decentralizing its administration in answer to persistent pleas from taxpayers. Thus, the advantage of remoteness becomes doubtful.

Administrator Bradley of South Carolina in his remarks from the floor of this assembly, only day before yesterday, struck a keynote when he suggested that the Bureau of Internal Revenue should so decentralize their work that a taxpayer could submit to examination by his neighbor, in whom he has confidence, rather than to some whipper-snapper referred to by Professor Paton.

Political pressure may exist in some jurisdictions, but when I look around this assembly and see integrity carved deep in the brow of every administrator here from President Maxwell down, I am led to believe that politics is completely washed out of the state administration picture.

The three provinces of Canada did not escape the normal collection costs at the time they were integrated with the dominion system. The normal annual costs were contributed to the Dominion to defray their additional costs. These provinces are now moving completely out of the income tax field, which is being surrendered to the Dominion on the promise of an annual grant equal to the provincial tax collection for 1940.

In Australia, where the Federal Government and all the provinces operate income tax laws, integration has taken place; and if I am correctly informed, one of the provinces integrated with the federal government whereas the other provinces absorbed the collection machinery of the federal government.

The integration of 35 state tax collection agencies, involving one-hundred million people, would be a much more complex problem than the integration of the Canadian systems with a population of five million people. We all know that in our rapidly changing political system the integration of all of the states is a positive impossibility, no matter what its economic advantages may be.

Chairman Groves: Our next subject for discussion is one that has often been before this Association. In fact, the person who is about to open up on the discussion of income allocation problems was the chairman of a committee appointed by this Association to examine and report on problems of income tax allocation. That report I believe was made to the San Francisco conference, and it was with the thought that further discussion of the subject was in order and very much desired that the subject was again placed on the program this year.

I am now happy to introduce the former chairman of that committee, Mr. Leo Mattersdorf, of Barrow, Wade, Guthrie & Company, accountants and auditors, of New York City.

DISCUSSION OF THE REPORT OF THE COMMITTEE OF THE NATIONAL TAX ASSOCIATION ON ALLOCATION OF INCOME

LEO MATTERSDORF
Accountant, New York

The Committee on Allocation of Income was created pursuant to a resolution adopted on the occasion of the thirtieth national conference on taxation held at Baltimore in 1937. (*Proc.* 1937, p. 528). At the time of appointing the committee the president of the Association defined its scope to embrace "not only the problems of allocation for state income taxation but also the general problems of allocation as they arise under the property tax, special taxes upon intangibles, the corporate excess, franchise, and similar imposts." (*Proc.* 1938, p. 486). The committee, however, confined itself simply to the problems of allocation for state income taxation and franchise taxes measured by income. Many of its members did not feel qualified to speak with authority on the other problems involved. (*Proc.* 1939, p. 219).

Two reports were rendered, the first a preliminary one, which was submitted at the conference in 1938 (*Proc.* 1938, p. 486) and a final report presented at San Francisco in 1939. (*Proc.* 1939, p. 190). Except for the scheduled comments at the 1939 conference, the program was so long that no discussion of the committee's report from the floor was possible. Consequently a resolution was adopted in New York in 1940, the essence of which may be summarized in the words of President Gerstenberg: "The idea would be to have a notice of the 1941 meeting which would direct attention to the fact that this report would be discussed, and that the report was to be found in the *Proceedings* of the 1939 conference, and the members would be asked to look it over and be prepared to discuss it." (*Proc.* 1940, p. 440). Accordingly, the June, 1941 *Bulletin of the National Tax Association* included a footnote to the tentative program published therein carrying out the desire expressed at the 1940 conference. We are, therefore, gathered here this afternoon to discuss the committee's reports and it is my hope that this conference will approve the committee's findings.

Those who will discuss the committee's reports will, of course, have read them in full in the proceedings, but it would not be amiss if I briefly review them and let Professor Ford, who will follow me, comment on some of the details therein.

Coming now to the 1938 or preliminary report of the Committee on Allocation of Income, we find that the committee first reviewed the results of the efforts of four previous committees which had studied the problem. In a sense, this is a short history of what has been accomplished by studies of experts in the National Tax Asso-

ciation covering a period of some seventeen years, namely, from 1916 to 1933, inclusive. (*Proc.* 1938, p. 487).

Next, there follows a general discussion of the problems involved in this question of allocation of income. On page 491 of the 1938 *Proceedings* will be found the only recommendation made in the preliminary report, namely, that uniformity in allocation should not be attained through action by the federal government, either by the device of credits for income or franchise taxes measured by income paid to the various states, such credit to be applied to the federal income tax, or by having the federal government collect these taxes and apportion them to the various states.

The balance of the report concerned itself with two questionnaires, one addressed to the tax commissions of thirty-four states as well as the Comptroller of the City of New York and the Commissioners of the District of Columbia, and the other addressed to corporations. In each instance the questions propounded by the committee were published and the reasons for the queries noted.

Prefacing the 1939 report (*Proc.* 1939, p. 190), the committee quoted from Marcus Aurelius' *Meditations* (Bk. ii, Sec. 1), "We are born for cooperation, as are the feet, the hands, the eyelids, and the upper and lower jaws." In my opinion this saying applies perfectly to our problem of allocation, especially in these historic and critical times through which our country and the world are passing. Here we have forty-eight separate sovereignties welded into a nation as living proof that peoples living together over thousands of miles of territory and with different problems, both economic and social, can yet be one. That though is summarized too in the motto which appears in the great seal of our country, "Out of many, one." Our states with their various problems may be likened to the parts of the body which have different functions to perform, but perform them for the one individual. I shall comment in more detail on this a little later on, but since I am covering these reports as they are written in the *Proceedings* I thought it well to again draw your attention to the purpose of that quotation.

On page 191 of the 1939 *Proceedings* the committee reiterated "that uniformity should not be attained by way of granting a credit against federal income taxes for state income or franchise taxes when measured by income, or the federal collection of state franchise or income taxes with apportionment of the proceeds of those taxes by the federal government to the states." It was then pointed out that the findings and recommendations with respect to formulae should not be confined solely to corporate taxpayers "but should likewise be extended to those cases where the form of business organization is that of single proprietorship, partnership, trusteeship, or any other." (*Proc.* 1939, p. 191). It was recognized that the underlying problems of all businesses in so far as allocation is concerned are the same.

Parenthetically, I might say that an excellent thought has been suggested since our report was submitted, namely, that the Congress of the United States, under the commerce clause of the constitution, enact a bill providing a formula, the application of which shall determine whether the apportionment by a state of net income for the purpose of a net income tax or a franchise tax measured by income imposes a burden on interstate commerce to the end that, by such a federal standard, the excess tax imposed by the taxing state over that which would result if measured by the federal allocation formula, shall be deemed to be a burden on interstate commerce. In my view this has not the objectionable features which the committee opposed and which I have just mentioned. It would not take from the states their main attribute of sovereignty, namely, the taxing power. Its objective is to prevent a state from imposing a burden on interstate commerce by taxing more than its portion of net income.

Next (*Proc.* 1939, p. 192), the committee summarized the replies received to the tax commission questionnaire and pointed out that there were in fact sixteen different types of formulae in general use by the states in allocating income. Ten states use the property, payroll and sales factors, while a number of others need only add a factor, or make a slight change in one now used, to raise the number of states to twenty-three out of thirty-two that would be using substantially the same formula. (*Proc.* 1939, p. 205). That, I think, is a very significant point to bear in mind and it refutes the assertion made by so many that uniformity is unattainable.

On page 194 there is an italicized sentence which cannot be too strongly stressed in discussing this problem as well as many others dealing with taxation. I quote it again: "*No tax procedure can be considered good which drives the taxpayer to unusual or uneconomic devices.*"

After the conclusion of the discussion of replies to the tax commission questionnaire there follows a similar summarization of replies received from forty-six corporations. (*Proc.* 1939, p. 198).

On page 201 is presented a report of a committee of the American Institute of Accountants, addressed to the Council of that body, dealing with the subject of allocation. It stresses the use of a separate accounting method for allocating income. It appears that this section of our report has been most widely commented upon. As an accountant, I might state here that I have not much hope that separate accounting can be used to allocate income of a manufacturing business and of certain mercantile establishments, but I do feel that it can definitely be used by a great majority of personal service organizations, by retailers and certain selling organizations. Further, I am hopeful that as the science of accounting progresses this method can be used for more and more businesses.

In presenting its conclusions and recommendations, our committee prefaced them with a statement that " The solution reached is wholly

practical and equitable." (*Proc.*, 1939, p. 203). I need not dwell at length upon those conclusions and recommendations since that phase of the reports will be covered by Professor Ford, but I do wish to stress the point made in discussing the sales factor in the allocation formula, to wit:

> "One of the main causes for the difficulties arising from the proper determination of the numerator of the sales fraction seems to be that too often the situs of sales is determined as though the sale itself were being taxed. When taxing net income or franchises whose values are measured by net income, the states *are not taxing* the *gross receipts or sales* but *are directly or indirectly taxing the net income* which is the result, not only of the sales, but of every other activity leading up to the sale in which the taxpayer may be engaged. The states, in the use of factors in a formula whether they be tangible property, payroll, sales or any other, should be guided *by the economic effort that produces the income. It is this economic effort evidenced by activity in various states that produces the net result, namely, net income.* For instance, where a tangible property factor is used, it reflects merely economic effort evidenced by investment location of property owned, source of supply, or source of revenue. There is no reason, therefore, to treat the sales factor any differently. It is merely another guide, and an important one, to the location of that economic effort which produces the net income base to be taxed." (*Proc.* 1939, p. 209).

On page 217 is printed a chart showing that the formula recommended by the committee for manufacturing and mercantile businesses gives proper weight to all their functions which result in the earning of income.

The committee concluded with certain general recommendations which are worthy of note. Since it had not proposed formulae for certain groups of taxpayers, it was suggested in the language of the report that "from time to time as the question becomes important enough for any large group of such taxpayers, a new committee be appointed to study the problem with respect to them, and that the membership of that committee be confined largely to experienced persons who understand the problems of such a group."

Except for the recommendation that tax commissions be given latitude in applying the formula for the group in which a taxpayer may be classed, if such application would work hardship, the remaining recommendations deal with cooperation between the various tax commissions to prevent tax evasion and to make sure that when uniformity is attained, the standard formula will be properly used by taxpayers in all states in which they do business.

At the conclusion of the 1939 conference I moved "that the secretary of the National Tax Association be directed to send one copy of the committee report to the governor of each state, including the territories of Hawaii and Alaska, and one to the tax commissioners of each state." I was advised that in December, 1939 Secretary Query carried out this resolution.

As I have already pointed out, much pessimism has been displayed regarding the likelihood of there being adopted by the states uniform formulae for allocating income. To many this is an idle dream and one might almost say that it is dismissed as impracticable with a wave of the hand. I cannot share that pessimism. At the same time I feel that I am practical enough to know that uniformity will not be attained over night. Further, I am willing to concede that it is a dream, but a dream only in the same sense as have been the dreams of all pioneers. They planned and if their plans were worth while they then became fruitful. Leonardo De Vinci dreamed of the flying machine. Even earlier men were dreaming of flying like the birds. It took centuries, but finally on the sand dunes of North Carolina that dream became a reality. So it has been with the steamboat, the telegraph, and a thousand and one other things which we today take for granted. First someone dreamed them, then someone planned them, and finally they became realities.

Possibly it may be felt that the analogy is too farfetched, yet let me take you back only ten years. Had anyone told a conference of the National Tax Association then that within five or six years every state in this nation would adopt unemployment insurance laws, the cry of "impossible" would have been raised. But, by 1936 practically every state had adopted such legislation. Admittedly, they had adopted it by the very device the committee here seeks to avoid, namely, action on the part of the federal government; but there were other constructive changes made in our statutes which were discredited as impracticable.

Another objection to the committee's report is that it does not cover specific problems or meet them squarely. The committee made no pretense that it had found an ideal solution. Business is so varied and so complex that as far as this particular problem is concerned it must be admitted that the ideal is unattainable. In the 1939 report it was stated that "Uniformity when applied to the problem of allocation can never be taken in an absolute and literal sense. Substantial uniformity must suffice." (*Proc.* 1939, p. 203). It must be borne in mind that the reports provide what might be called a compromise solution. There are covered the vast majority of cases which will come up with respect to manufacturing and mercantile establishments as well as loan and personal service companies. It was recognized by the membership of the committee, which included tax administrators, tax practitioners, taxpayers, and students of taxation, that the problems and business methods of all

taxpayers cannot be reduced to one common denominator. One can always find taxpayers with unusual problems and it is for that reason it was recommended that tax commissions be granted some latitude. Can anyone point his finger at any tax law, or any other law for that matter, no matter how expertly drawn, which has that finality about it as to cover without question every problem which might arise? Why, then, look for every possible answer here? The same arguments that are leveled against the committee's report can be leveled many times over against the non-uniform practices with the resultant inequities which exist today. It is humanly impossible to attain perfection.

There is one other argument about which I wish to say a word before I close. Much has been said by those who have so far commented on the findings of the committee that in the use of a sales destination factor, income will or may be allocated to a state not having jurisdiction to tax. The committee knew this when it adopted the recommendation, but it pointed out that, by the same token, the numerator of the sales fraction of those corporations subject to the jurisdiction of the states where they do business, probably will be increased, thus resulting in additional revenue. Besides, even today, with the use of the various formulae in existence, much income can be and is allocated to states having jurisdiction over taxpayers but having no income tax law or franchise tax measured by income. While I presume that the critics of the report in advancing this argument have in mind the day when all states may have these types of taxes, I think the states should stop worrying about how much the other states are not going to get, but endeavor to see that their own taxpayers are taxed equitably and fairly.

Let us endeavor then to have the states voluntarily consider the interests of their citizens and taxpayers in the light of the common good of the nation. In these days when we are doing so much to prove to the world that democracies are practicable, and when we must pay heavier and heavier taxes to the federal government, the states should do every thing in their power to relieve of inequities those under their jurisdiction. This question of allocation may seem infinitesimal with respect to the greater problems of a more immediate concern to the country today, but just as everyone can do his little mite so that in the aggregate it is a mighty effort, so even the removal of this irritation will help towards the realization of those principles for which we as Americans stand. This is not the time to drop this problem entirely because there are weightier ones. This is the time to cooperate on all problems so that the principal one may be fulfilled. As the states voluntarily cooperate on matters which concern them collectively, they will have proceeded a long way toward realizing the ideal of him who placed in our great seal the motto "F Pluribus Unum," for out of the many there will be truly one.

Chairman Groves: The discussion on this subject of income tax allocation will be continued by Professor Robert S. Ford, of the University of Michigan.

Robert S. Ford: Mr. Chairman, Ladies and Gentlemen: Mr. Mattersdorf has considered the report as a whole. My remarks will be confined to that section of the committee's report which deals with the need for uniform practices and rules in determining the numerator of the apportionment fraction.

DISCUSSION OF THE REPORT OF THE COMMITTEE OF THE NATIONAL TAX ASSOCIATION ON ALLOCATION OF INCOME

ROBERT S. FORD
University of Michigan

I shall confine my remarks to that section of the committee's report which deals with the need for uniform practices and rules in determining the numerator of the apportionment fraction. Offhand, it would seem that if the thirty-two income-taxing states used the same three factors—property, payroll, and sales—in their apportionment fraction, uniformity would exist. It is obvious, however, that even with this situation, there might be a considerable degree of non-uniformity if each factor were not assessed in a similar manner for each state.

A corporation's tangible property may be valued differently in some states from what it is in others, and it would be possible, therefore, to include in the numerator for one state a disproportionately large share of the total value of the corporation's entire property. This was recognized by the committee in its recommendation that "the tax commission allow the taxpayer some latitude in this respect, prescribing only that a taxpayer must indicate in his return that he uses the same basis of valuation in every other state in which he may be subject to tax measured by income." The committee also pointed out that there should not be included in the fraction any tangible property yielding a rental that is subject to specific allocation; nor should it include any tangible property not used in the business.

Administration of the valuation provision would be facilitated by two other recommendations as follows: (1) "that when uniformity has been more nearly established, the tax commissions require that taxpayers disclose on their returns not only in what other states they do business but also report the amount of net income allocated to such other states"; and (2) "that there be more cooperation between various tax commissions to the end that when uniformity is attained, the interchange of information will be helpful in preventing evasion and in promoting uniformity in administration."

The treatment of the payroll factor is much easier than that for property or sales. It is the practice in most states to apportion wages and salaries to the office in which the employee works or to the state where is located the office out of which he works. It was the opinion of the committee that this method is fair to taxpayers and to the states.

One of the most difficult questions involved in the use of an apportionment device relates to the determination of the situs of sales, and a great deal of consideration was devoted to this question by the committee. At an early stage of its deliberations a subcommittee, composed exclusively of attorneys, studied legal decisions to determine what definite rules the courts had laid down regarding the situs of sales, but it found very little in weight of authority that would be helpful.

In making its recommendation for adoption of a definite rule of situs, the committee considered six different methods. It is unnecessary to review them here because they are discussed in the report. After a consideration of the relative advantages and disadvantages of each, it was recommended that each sale be allocated as follows: 50 per cent to the state of destination and 50 per cent to the state from which the salesmen operate. With the sales factor being weighted at one-third in the apportionment fraction, this would mean that one-sixth of the income subject to apportionment would be allocated to the state of destination of the goods sold and one-sixth to the state from which the salesmen function.

Although the advantages and disadvantages of these two methods are given in the committee's report, it seems appropriate to repeat here a few of their chief merits. Apportionment of a part of the sales to the state of destination has the following advantages:

1. This is the state where the salesmen generally perform their work and create a demand for the taxpayer's product.
2. If the consumer purchases the product because of the advertising of the taxpayer, it is the state in which the demand for the product is created.
3. The method is definite and cannot be manipulated, and it recognizes the source of wealth which creates the income.

It should also be mentioned that several corporations, in replying to the committee's questionnaire, recommended the adoption of this method.

The chief advantage in allocating a part of the sales to the state from which the salesmen operate is that such a state can logically claim jurisdiction over the taxpayer because of the salesmen's operations.

Perhaps some mention should be made of the method of assigning situs to the state in which the sales order is accepted. Although

great weight has been given to this principle by the courts, the committee was of the opinion that it was defective for several reasons:

1. It lends itself to manipulation because the office where the order is accepted can be shifted easily to another state.
2. The credit may be accepted in one state and the order in another.
3. It may be an open question in many cases as to where the order is accepted.
4. This method frequently overlaps with that of attributing situs to the state from which the salesmen operate.

It was the opinion of the committee that the courts, in attaching weight to this method, had placed the emphasis on the sale itself rather than on the economic activity which produces the income.

The combination of the two methods suggested by the committee reflects the chief aspects of sales as a factor in producing business income. This is in accordance with the criterion that should govern in the selection of factors for inclusion in the apportionment fraction, namely, that they will reflect the full amount of income attributable to each state. Frequently, as was pointed out by the committee, the situs of sales is determined as though the sales were to be taxed, whereas the purpose is merely to determine the location of the economic activity that produces the income. We are all aware of the fact that sales contracts are often drawn up in such a manner that the transaction will be regarded as having been completed at some point other than the jurisdiction in which the purchaser is located. It is not the contention of the committee that all sales should be apportioned in accordance with the destination factor, but it is their belief that this factor should receive recognition in the allocation of corporate income.

In making these recommendations, the committee stated that it "could unearth no other single formula which holds out greater hope of suitability for the general run of taxpayers conducting mercantile or manufacturing establishments. Other formulae for these types of taxpayers would probably not result in fewer difficulties and under present conditions might present greater difficulties as far as ultimate adoption looking to uniformity is concerned."

Finally, it should be mentioned that this is not a hard-and-fast rule to be applied without exception, for there will undoubtedly be many instances when the formula will not operate equitably. The committee recommended, therefore, that where a taxpayer could show that the formula would cause injustice, the "tax commissions be given sufficient latitude to permit the taxpayer to use additional or substitute factors or reduce or increase the weight of prescribed factors. This should particularly be the case where a taxpayer can show that a number of other states acceded to the request."

There are few who will contend that this is not a reasonable method for dealing with the allocation problem. Obviously, it will require some concessions on the part of various states, but this is inevitable in a compromise solution designed to meet many conflicting interests. It has the merit of providing a more definite guide for the states than has thus far been recommended for the voluntary solution of this particular interstate problem. If the states are unable or unwilling to deal with this question on a voluntary basis, it is not unlikely that the federal government in the near future will initiate a more vigorous plan for achieving uniformity.

CHAIRMAN GROVES: This completes the formal part of our program, and these papers are now open for discussion. I notice the time is twenty minutes to five, and we have at least 20 minutes and I think we can probably steal a few extra ones, so that we should have a good discussion.

HENRY F. LONG (Massachusetts): Mr. Chairman, I will steal this opportunity if I may, of reading the resolutions which can be referred to the Resolutions Committee. With the request, if I may, that these be put into better English subsequent to their being read and with the observation that someone translate them into good English, I would like to make the following resolutions:

"WHEREAS the present emergency has vastly increased revenue needs of the federal government and that the national interest demands that these requirements be met as far as practicable, the Thirty-Fourth National Tax Conference, conscious of such opinion, therefore

"RESOLVED that it is important that in seeking additional revenues, the federal government shape its tax policies so as to preserve the independence and autonomy of our state and local governments, and further

"RESOLVED that the federal government should give due consideration to state revenue needs and not encroach upon established sources of state taxation, and further

"RESOLVED that the states should be watchful in this situation and under definite obligation to make their views known to federal agencies at this period of our history when our tax resources are endangered; and

"RESOLVED further, that while it is to be recognized that some states are at present enjoying a condition of revenue surpluses, this condition will not continue if the emergency should prove to be of long duration, and that all states should unite not only for present benefit and protection from federal inroads into state and local revenues, but also in the nature of protection for the future fiscal needs of states and their political subdivisions."

I assume, under the rules, that that is referred to the Committee on Resolutions.

The second resolution:

"WHEREAS the National Tax Association has lost one of its most valuable members in the passing of Charles Jesse Bullock, it is most fitting, in view of his peculiar relationship with the Association, which, in the minds of many, represents the core around which the Association for years has evolved, and which is still controlled by the principles that he so firmly established and insisted upon through the many years that he was the counsellor and friend of the Association and of its many members, that the thirty-fourth annual tax conference adopt this resolution, therefore be it

"RESOLVED that the thirty-fourth annual tax conference hereby make as a matter of permanent record in the proceedings of this conference, not only the deep appreciation and reverence for Professor Bullock, who through many years not only wrote and spoke in ways which made paths easier for those who are engaged in public finance but who also exemplified the forward-looking and responsive spirit on which the conference itself is founded; and that while he was a strong exponent of the fundamentals which seem not to have varied through the years, he was not unmindful of new aspects of those fundamentals, and generously welcomed from all the expressions of means by which public finance could be improved and with unswerving devotion to what he called the best principles in public finance, tested all new proposals in the light of many years of experience.

"The National Tax Association by this resolve makes permanently of record its very deep reverence for him, and in making this a matter of permanent record, it voices not only to those who have attended this conference but those who have attended many in the past, their affectionate reverence for Charles Bullock and their deep and lasting sorrow at his passing."

I offer that, and assume under the rules it goes to the Committee on Resolutions.

I am grateful to you, Mr. Chairman, for permitting that interruption.

E. P. Doyle (New York): I want to protest against any further attempt on the part of anybody to destroy the autonomy of the states. There has been a consistent effort in the past for some years to destroy the autonomy of the states, under which form of government this country has become the greatest country in the world. No totalitarian state in the world has ever had it happen. I have been in all of them, and you don't want to live in them. We don't want such a state here. We want the old state governments as we

have always had them, and I think we should protest against any attempt to change that autonomy.

CHAIRMAN GROVES: I would like to give everybody a chance to talk, but we had a letter making a special request to make some comments on this allocation problem from Mr. Henry Powell, of New York City. Is Mr. Powell here?

MR. MATTERSDORF: No, he isn't here, Mr. Chairman. He wanted the chairman to read his paper, as I understood it.

CHAIRMAN GROVES: I didn't get any paper, however.

MR. MATTERSDORF: Well, the secretary has it.

MR. LONG: I move, Mr. Chairman, to keep the record clear, that we vote now to permit Mr. Powell's paper to be included in the proceedings of this session.

MR. MATTERSDORF: I second the motion.

CHAIRMAN GROVES: It has been moved and seconded that Mr. Powell's remarks be included in the proceedings. All in favor say "Aye."

("Ayes.")

CHAIRMAN GROVES: Contrary, "No."

(None.)

DISCUSSION OF 1939 REPORT OF N. T. A. COMMITTEE ON INCOME APPORTIONMENT

HENRY M. POWELL

Associated Industries of New York State, Inc.

Fractional Formulae:—Of the thirty-two or more states that have adopted a corporate franchise, or an income tax, approximately two-thirds of them, comprising nearly one-half of the population of the United States, use fractional allocation formulae, more or less similar, based on sales or receipts plus payrolls plus property values. Nearly all of them make use of the property allocation. The accounting method of allocation is permitted by some states under certain conditions.

In general, I find a marked trend to greater uniformity, particularly in the larger manufacturing and mercantile states, such as New York, Pennsylvania, Massachusetts, California, Wisconsin, etc. There is also a tendency to a broader and more flexible system of allocation. For example, New York in addition to permitting the fractional allocation formula of property values plus accounts receivable plus stocks, also permits the use of the Massachusetts formula in certain cases, and for its unincorporated busi-

ness tax it permits, in some cases, a separate accounting method of allocation. Pennsylvania now uses the Massachusetts method of allocation for its corporate income tax.[1]

It is perhaps presumptuous to expect every state to adopt a uniform or even approximately uniform system of allocation. The states differ from one another in material resources, population and development and these have an influence not only on their tax systems but on the nature of the allocation formulae. For instance, New York as the financial center of the United States, has a special form of allocation and a different rate of tax for the so-called "investment trust". It now eliminates money and cash on hand and on deposit from its allocation formula.

Separate Accounting Method:—On the subject of separate accounting methods for corporations doing an interstate business I find that its adoption for allocation purposes results in diversity rather than uniformity. Dr. Ford in his excellent report on the allocation of corporate income for the State of New York says that separate accounting involves ascertainment of profit of each branch of the business, entailing selling profit as well as manufacturing profit, and that it consists not of a single method, but of many different methods depending on the nature of the business.[2]

Another distinguished writer says that "It is almost as futile to attempt to allocate profits to different functions of a business concern on the grounds of pure theory as it is to try to discover how much of the cutting is done by each blade of a pair of shears." [3]

My own experience leads me to believe that the separate accounting method can only be adopted in a limited class of cases and only where there are specific data and books of account for each branch and where this can be done with a minimum use of figures. This may be done where, for instance, there are two distinct organizations, manufacturing or mercantile, each in a separate state, with its own sales force, factory and operative force, and where there are no interlocking transactions. It may be done in the case of realty corporations with realty transactions, profits and income, each division in a separate state, or it may be done in the case of a service corporation in which the machinery and fixtures are relatively unimportant in value and in which the service may be easily separated for each state.

Protagonists for the separate accounting method should distinguish between states in which income is the measure and the franchise or excise is the subject of the tax and those states adopt-

[1] The Massachusetts method employs average tangibles plus payrolls plus gross receipts in numerator and denominator, the result divided by three.

[2] Dr. Ford's 1933 *Report on Allocation*, p. 25.

[3] Alfred Marshall's *Principles of Economics.*

ing the straight income tax. New York, Massachusetts, and California belong to the first class, Wisconsin in the other class. New York, Massachusetts and California do not permit the separate accounting method of allocation, but New York does permit it for its unincorporated business tax.

Too much importance by accountants as well as by lawyers should not be placed on the outstanding *Hans Rees* case.[4] That case occurred in North Carolina, an income tax state. There the corporation presented proof to the State Tax Commission that only 17% of its income was realized in North Carolina and that its buying, manufacturing and selling was largely outside of the state. The State Commission imposed a tax of 75% to 80% on its income earned in the state. Proof as to its income earned outside of the state was stricken out by the state court. The decision of the United States Supreme Court was really based on the refusal of the state court to consider the proof thus disallowed and it was remitted to the Tax Commission for further proceedings. On the other hand, in New York where franchise is the thing taxed and is measured by the net income of a corporation from whatever source derived, we have two notable cases[5] in which the Supreme Court refused to measure the tax by the income earned in the state, but computed the business in and out of the state as a unitary business, adding the profitable to the unprofitable part for tax purposes. An additional practical element to be considered by those favoring the separate accounting practice is the difficulty in the larger states in the administration of hundreds or even of thousands of cases where the accounting method might be considered, each from some new theoretical basis of accounting. For instance, buying, selling, manufacturing, distribution and storage may have an importance in the apportionment of income for the separate accounting method; whereas under the fractional method, the aggregate net income is considered.

Federal Credits Allocation:[6]—On the subject of federal credits or a federal method of apportionment. There are some trusting souls among us who believe that the federal government treating the states like the Indians as wards of the United States, can furnish each state with an allocation blanket that would exactly fit its taxable nakedness. It has been suggested, for example, that the federal government could furnish an allocation formula in which the amount disclosed as federal income would be distributed among

[4] *Hans Rees Sons, Inc.* v. *North Carolina*, 283 U. S. 123 (1932).

[5] *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U. S. 271 (1924); *Gorham Mfg. Co.* v. *State Tax Commission*, 266 U. S. 265 (1924).

[6] Seligman's *Essays on Taxation*, p. 387. The Committee refused to recommend this method. See 1938 National Tax Association *Proceedings*, p. 491.

the states according to the source of income. Aye, there's the rub. What is the source of income? The United States under this system would establish as the source of income whatever they determine that cabalistic term should mean.

Hon. Mitchell B. Carroll [7] says that Congress under the interstate commerce clause might enact a compulsory formula and that a special federal agency might apply it. Is there any ground for believing that this can be done by federal administrative machinery any better or more equitably than by such great administrators as Henry F. Long, Mark Graves, Dr. Groves, and others whom I might mention. Mark you, this whole problem of allocation is focused around the states that have an income tax. What of a state like New Jersey which formerly taxed foreign corporations on realty and personalty in the state and taxed corporations organized in that state, irrespective of where their business or property or income was earned. How would this apply to states having a capital stock tax system in which the allocation is based entirely on property values?

Professor Haig, in writing of the extension of federal credits for corporation income and franchise taxes, refers to the many differences that exist between such taxes and estate taxes and he adds, "the potentialities for the alleviation of existing ills are extremely limited." [8]

Since the scope of the committee's inquiry embraces not only allocation of income taxes, but also the allocation of property taxes, intangibles, corporate excess and similar imposts, if the national government may apportion these too, are there not serious questions of direct taxation and of constitutionality involved? The powers of federal apportionment may also mean, to paraphrase Judge Marshall's words, "the power to destroy state taxation". [9]

CHAIRMAN GROVES: We are now open for general discussion on any of these papers. Just give your name to the reporter and go right ahead.

J. V. MORGAN (District of Columbia): I would like Professor Ford to answer this problem, one that we have quite frequently in the District of Columbia. This is a very common pattern. Let us say a manufacturing corporation with a home office in New York will send to the District of Columbia a solicitor, who solicits an order, and who takes the order back to his home office for approval, whether for conditions of credit or any other reason; what are we going to do in the District of Columbia when we attempt

[7] 34 *Columbia Law Review*, p. 493 (1934).

[8] National Tax Association *Bulletin*, Vol. XVIII, p. 73 (Dec. 1932).

[9] Congress may not impair the necessary taxing agencies of the states; *Income Tax case of 1895; Collector* v. *Day*, 11 Wall. 113.

to allocate income and the taxpayer says, "You have no constitutional authority to tax, under two well-known decisions, the *East Coast Oil* case and the *Philippine Tobacco Company* case." Where is all your theory of allocation going, if we can't tax them? And if New York then will apply the allocation formula, the taxpayer gets out of some proportion of tax on 100 percent of the net income. What are we going to do about it? Where do all our theories go when they won't pay it in the District of Columbia?

MR. MATTERSDORF: I can answer that question. In the first place, if I recollect correctly, the District of Columbia has taxed those individuals under the gross receipts tax.

MR. MORGAN: No.

MR. MATTERSDORF: Well, it did attempt to. It levied a license tax.

MR. MORGAN: It does not have one now.

MR. MATTERSDORF: Well, it probably is to the good. I think that the emphasis on the lack of jurisdiction is not correctly placed. The amount of revenue that a state would get is inconsequential. In a case of that kind, though, the one you cite, I doubt that the state has jurisdiction to tax, in the first place, because the entry of a salesman into any state does not constitute, so far as I know, the doing of business in that particular state. So that it is not an important thing.

If you are arguing, on the other hand, that some other state will lose the revenue because that particular sale is not going to be allocated to any state, I repeat what I said in the paper—that you often have the case today where allocation is made to a state where there is no tax on income, and the revenue is lost to all the other states that do tax on income, and nothing is gained, in any event, unless I misunderstood your question.

MR. MORGAN: I think your observation is splendid. I don't think one jurisdiction ought to be concerned with what the other jurisdiction does. It either has a right to tax or not.

But if I understood Professor Ford, in a case like that they would apply the formula, or they recommend the application of the formula and disregard, if I understand, the constitutional prohibition of taxing of any of that income in the state. They just brush it aside as if the courts are going to follow on these allocation formulae. They are not going to do it, if they follow the decisions of the circuit court of appeals and the United States Supreme Court.

MR. MATTERSDORF: Well, I know that isn't what Professor Ford said. He followed very closely there what the committee said. The committee merely, of course, states that the state that has the

right to tax shall do the taxing and use the allocation formula, if it adopts the committee's report, follow the committee's formula. And if the state of destination happens to be some state where there is no jurisdiction to tax, that particular part of the fraction is lost—there is no question about that.

But, in your instance, if the District of Columbia happens to be what we call the state of destination, why, that much is lost. The District would not have the right to tax. That isn't in the report, and I frankly believe Professor Ford didn't say that.

MR. MORGAN: I am glad to hear you say that, but I didn't understand it that way. I understood him to say that in that case they would allocate some portion of the income to the state wherein the salesman sold the material or at least procured the sale, regardless of the fact that the order was approved in the home of the corporation.

MR. MATTERSDORF: Let me summarize that part of the committee's report in this way again: that the sales factor would be split into two parts. In other words, let us take a sale of $100 made by a salesman working out of a New York office to a customer in the District of Columbia. The District of Columbia in the instance you cite would not have the jurisdiction to tax, but the State of New York would have the jurisdiction to tax, because the taxpayer would have an office there, and be subject to its jurisdiction. Then in the allocation fraction, the State of New York would take that $100 sale, break it into two parts, and put in the numerator only $50. The other $50 would be lost. But, by the same token, anyone else, if the destination was in New York, the other $50 would come into New York.

MR. FORD: Just to keep the record clear on that, let me just add that I agree thoroughly with what Mr. Mattersdorf has said, and it was not my thought at all that the court would disregard the constitutional question, that there would be many instances where this particular factor could be used. There would also be many instances where it could not be used. It was not to suggest that it be applied to all cases indiscriminately. Not only constitutional questions should be considered; there would likewise be instances where a separate accounting would have to be followed, and also instances where one factor might be dropped.

SOL CHARLES LEVINE (New York): The question asked by the gentleman from the District of Columbia makes an assumption in the light of the decisions of the so-called runaway court, today, that may not be in the least correct, and that is the assumption that we are within a particular jurisdiction, where in a particular jurisdiction all you have is a salesman coming into that jurisdiction, that the District of Columbia would not have the jurisdiction to

impose a net income tax on that concern whose representative has been sent there.

The reason why I say that the answer assumed there is not so clear appears from the recent decision of the Supreme Court in the *J. C. Penney* case. In the *J. C. Penney* case the tax involved there, at least as I read it, was a tax upon the income of a non-resident shareholder in a non-resident corporation which was doing business in the State of Iowa. If you look upon the tax in that case, in that precise light, the old conceptions of jurisdiction have certainly been deleted by the court; from the viewpoint of the stockholder who has been taxed, he personally, except in the remote technical sense of being a member of a corporation that is doing business in Iowa, has none of the usual contacts with the State of Iowa.

It is true that when Mr. Justice Frankfurter wrote his opinion, he interpreted a statute, contrary to the interpretation of the dissenting Justice, Mr. Roberts, to be nothing more than an additional net income tax upon the corporation, rather than upon the shareholder. But the expressed language of the statute imposing the tax, as was pointed out by Mr. Justice Roberts, was that it was a tax upon the non-resident shareholder to be merely collected by the resident foreign corporation.

So I think that we can't be too sure that under the facts presented, the present Supreme Court will not say that the District of Columbia is entitled to an allocated tax on the income allocated to the District of Columbia by reason of the fact that sales were made there.

Robert Buchanan (California): Professor Ford cleared up some of the uncertainty and confusion, I think, that there was here; at least the question arose in my mind as to whether it was the idea of the committee to have this destination test a more or less exclusive test, and apparently that is not so. In that connection, I think it is of interest to know that the Tax Commissioner of California has had that very problem, and has ruled the destination test would not be considered in those cases where a manufacturing company shipped practically 100 percent of its product out of the state and practically 100 percent of the sales were accepted outside the state.

His position is that the income arises not only from the sales but primarily from the manufacturing within the state, and, in that case, California allocates 100 percent of the sales to the state on the ground of the net income arising from the economic activity within the state.

That is a very pressing problem in California, because we have so many companies whose manufacturing activity is 100 percent within the state, and whose sales are practically made outside the state, and I would be very interested to hear Mr. Mattersdorf's reaction as to how he would handle that type of problem.

CHAIRMAN GROVES: Would you say just a word, Mr. Mattersdorf, as to the practice in the states with regard to any use of this destination factor thus far?

MR. MATTERSDORF: I think that the destination factor has not been used in any state. Of course, I don't know whether Mr. Buchanan means that, or whether in that case the company did business in more than one or two states. Was the business confined to California?

MR. BUCHANAN: The sales were made all over the United States, but practically 100 percent outside of California. However, all the manufacturing is done within the State of California.

MR. MATTERSDORF: Did it have offices in other states, doing business in other states?

MR. BUCHANAN: Yes.

MR. MATTERSDORF: Well, of course, that is the general failing, I think, in the whole state system, that the states do not recognize, if it is to their advantage not to recognize it, that other states may be in a different category.

Let me say this very briefly: one of the biggest problems confronting the committee was this: that there are many states here in the Middle West which are the so-called buying states, without which I think we are very frank to concede the industrial states could not exist, and they have always felt that the Massachusetts formula was unfair in that it tended to allocate for a manufacturing company two-thirds of its income—namely, the fact that the payroll followed the property factor tends to do that—to the state of manufacture. Remember, if we are to have uniformity every state must recognize the problems of every other state. In your particular case, I think that the tax commissioner of California acted just as probably every other tax commissioner would who felt that if no other state was using the designation factor, California might just as well get its lion's share. That is the trouble with that.

MR. FORD: Mr. Chairman, may I just add a word to that, also? Mr. Mattersdorf certainly answered the question completely; but I am just reminded of the classic case in the allocation problem, namely, the old *Underwood Typewriter* case which posed this very problem of the company having most of its tangible property located within the State of Connecticut, and its sales being made all over the United States. In that particular case, it was contended that the State of Connecticut was attempting to tax too much of the income, to the disregard of the interests of other states. It so happened that not enough evidence was produced in that case to demonstrate that the Connecticut factor which consisted only of tangible property was unreasonable.

But that was probably the point of departure for the *Hans Rees* case, where the accountants did demonstrate the profits arising in various states.

That situation does pose the problem, and, as Mr. Mattersdorf mentioned, probably many other states would have handled it in just that manner. If the states are ever going to get together in uniformity, however, it is going to require some concessions on the part of various states, and they cannot deal with this problem to the utter exclusion of all other states, because the sales constitute an important factor in the determination of the amount of total net income and not manufacturing activities alone.

J. W. OLIVER (New York): I just would like to ask the gentleman from California what he would do with a corporation that has a factory in Oregon, and ships all of its property into California.

MR. BUCHANAN: In that connection, it is interesting to note, I think, that the gentleman from the District of Columbia said that the commissioners in one state are not interested in whether they pay taxes in another state. The way they handle it on the Pacific Coast is that the commissioners of Washington and of California have a very close liaison, and if you say that you are not taxable in California, they say, "Well, we will tax you in Oregon, then." That is how they handle that problem.

WILLIAM E. BROWN (Wisconsin): On this point of jurisdiction of tax by the District of Columbia, and Mr. Levine's remarks on it, I don't believe that the *Penney* case indicates at all that the District might have jurisdiction to tax. In the *Penney* case the facts are that the J. C. Penney Company was licensed to do business in Wisconsin and was doing business there, and the tax was characterized as more or less an additional income tax, so that there the company was actually subject to the jurisdiction of the Wisconsin tax.

MR. MORGAN: Mr. Chairman, I understand it is a violation of the rules to speak twice on any one subject. May I ask for leniency, and for you to excuse me?

CHAIRMAN GROVES: Is there any objection to the gentleman speaking twice?

MR. MORGAN: I want to say that I was about to make the same observation as the gentleman who just sat down. I didn't understand the *Penney* case as deciding anything like that. Of course, I might say that the gentleman from the corporation counsel's office in New York is right in warning that no reliance can be put upon any prophecy of what the Supreme Court might do tomorrow, the next day, or any other time. I agree with him to that extent. But there are two cases that stare us right in the face. One is the *East Coast Oil* case, decided by the circuit court of appeals, whereby

the United States was prevented from taxing oil of a foreign corporation sold by a salesman in the United States but approved in Tampico, Mexico. The circuit court of appeals, and, I think, the district court, held that that sale was localized in Tampico, and the place of the sale was the place where the entire—not a part—net income was earned.

The other case, which went to the Supreme Court of the United States and antedated the *East Coast Oil* case, was a tobacco company, I think, of the Philippine Islands. There the Philippine Islands government undertook to tax all the net income of the company on sales made by salesmen in the United States but approved back in the Philippine Islands. The Supreme Court held that the entire net income was earned in the Philippine Islands, where the contracts of sale were approved.

With those staring you in the face, I can't see what you are going to do in the cases that I have enumerated, where the salesman takes the order back or sends it back to the home office.

Mr. Levine: May I have the privilege of speaking again?

I merely want to state that the imposition clause in the *Penney* case was a tax upon the net income upon the privilege of declaring dividends, or receiving dividends, so that if you read the whole imposition clause, as the dissenting Justice did, what really happened there, the recipient and non-resident merely received dividends from an admittedly resident corporation, and the dissenting Justice pointed that out, as going much further than the court had ever gone before.

Philip Zoercher (Indiana): I rise to a point of order. I think this meeting was to close at five o'clock, and the Committee on Resolutions is to meet in this room at that time. It is five o'clock now.

Mr. Long: It seems to me, Mr. Chairman, that is right in line with this discussion. If that isn't a clear demonstration of allocation, I have never seen one.

Chairman Groves: I guess that constitutes a motion for adjournment.

Is there a second to the motion?

(The motion was duly seconded.)

Chairman Groves: All in favor say "Aye." The meeting stands adjourned.

(The meeting thereupon adjourned, at 5:05 o'clock, p. m.)

SEVENTEENTH SESSION

WEDNESDAY, OCTOBER 15, 2:00 P. M.

Spanish Room, Lowry Hotel

ROUND TABLE CONFERENCE

J. H. Bottum, Jr., presiding.

CHAIRMAN BOTTUM: The discussion this afternoon covers a very important field. The taxation of submarginal lands has received all too little attention. Taxing officials have been inclined to hold up values in submarginal areas, being motivated by some value feeling that a shrinking of the tax base is a reflection upon tax administrators and assessors. Such a practice merely prolongs the evil day when taxing officials will have to approach the assessment of all property upon a scientific basis even though in so doing they are forced to admit that there is not as much value within a given taxing district as the assessment records did show, and even though such scientific assessment procedure did prove the necessity for financial assistance from other taxing districts or other tax sources in the wealthier and more fortunate taxing districts.

I do not propose to offer any solution myself as we have some very learned gentlemen who have spent a great deal of time in preparing papers covering this subject for us.

(The following papers were then presented.—ED.)

TAX DELINQUENT LANDS IN A LAND USE PROGRAM

HUGO C. SCHWARTZ

Bureau of Agricultural Economics, Department of Agriculture

Laws that govern enforcement of real property tax collections have been traditionally just what they imply—sanctions designed to constrain landowners to yield the taxes which their governments have levied. The law says to the landowner: Either you pay your taxes or you lose your property.

In practice however, we know that generally tax enforcement policy is notoriously weak. In practice, what the government says is, that we, the government, are not at all interested in owning your property; we merely want to collect our revenues. We must insist that you bear your apportioned share even at the very regrettable expense of losing your property, which, for our part, if you default, we propose to transfer mechanically to any third party willing to

pay what you owe us. Again, we assume that through the automatic play of private enterprise your land will find its way into hands capable of making it discharge our claims. Finally, we have no responsibility in examining the condition of your land; we do not care how it's managed nor do we have to make any effort to determine whether it can pay our claims under the prevailing system of utilization, or under its present situation with respect to size, location and productive capacity.

This over-simplified statement of the case I have said in this way, advisedly, so that I can underscore what I am convinced is a fair generalization: Traditionally, tax levying governments have not thought it their business to plan with respect to properties that may fall to them as a consequence of tax delinquency.

Before 1930 this was an understandable attitude. It is still an understandable attitude in fairly good or better farming areas, as well as in other fairly prosperous sections of the country. Where tax delinquency has not been serious—where the private enterprise of an area is sufficiently prosperous to support the governmental structure—the taxing government can afford, perhaps, to act as a *mere tax collection* agent.

But it is in the less fortunate areas—where there are lands that are marginal and sub-marginal for the usual farming operations—where weather hazards, drainage problems, or other factors make it extremely difficult for the land to yield an adequate living to the operators—as I say, it is in these hardpressed areas, that many observers are now persuaded, on the basis of a great deal of evidence gathered during the last decade, that traditional assumptions underlying the proper role of government in the tax collection enforcement process, need thorough re-examination and revision. I am not admitting here that evidence does not exist to indicate that even prosperous regions should reexamine and revise their tax collection enforcement process, but I am insisting that significant revisions are particularly necessary in those agricultural areas where farmers are having a hard time to make a living.

Especially dramatic examples of related tax delinquency and land use maladjustment are afforded in the northern lake states and the northern great plains. For example, there are approximately 25 million acreas delinquent for more than five years and subject to tax deed in the northern plains states; and many millions more that have reverted or are subject to reversion in the great Lakes states —principally in cut-over areas. Less dramatic though hardly less malignant examples may be cited from all parts of the country, south, east, north and west. Pacific and Gulf coast cut-over areas, the Missouri Ozark region, the State of Florida, many suburban areas and many other regions have significant problems of chronic tax delinquency. In fact, most states have their problems of chronically delinquent rural lands to a greater or less extent. In large

areas in some states this has been accompanied by abandonment of farms and irresponsible absentee ownership of much of the land. Moreover, the ever increasing "delinquency domain" is land to which legal title is obscured by conflicting claims, and excessive costs involved in establishing title. It constitutes a veritable no-man's-land subject to destructive exploitation, and is barren of revenues, either to the owners of equity, or to the taxing jurisdictions.

That the legislatures have become uneasy over this vexing malady is evidenced, among other things, by the various tax indulgence statutes enacted during the past decade. Nevertheless, tax indulgences may be little more than palliatives to relieve temporary distress. Certainly, they do not serve to remedy the land use ills of which chronic tax delinquency is so largely a symptom.

We now know from hard experience that large areas of land cannot be restored effectively to the tax base or made to contribute their just share to government support, unless a more systematic and far-sighted attempt to get at the causes of their delinquency is instituted. We now know, again from hard experience that the taxing government often cannot find a private purchaser who is willing to pay up back delinquent taxes and to undertake future tax playing obligations. Moreover we know that private purchasers, who do buy tax reverted properties under the present prevailing tax-sales system often are likely to be disappointed.

The question I should like to pose and to sketch briefly is: What sort of tax enforcement policy is called for in such situations?

Let me say, first, that I do not mean to suggest, at all, that tax enforcement procedures should not continue to serve their accustomed purpose, which is to provide sanctions to force unwilling or negligent property owners to pay needed taxes. What I do mean to say is that new elements need to be introduced into tax-collection procedures, and that governments need to assume a new attitude of responsibility toward chronically tax-delinquent lands.

To begin with, this means that taxing governments need to take stock of and to classify tax forfeited lands before taking any steps to dispose of them. Machinery should be set up whereby the government can calculate the most advantageous use to which tax forfeited land might be practicably adapted. To come at all near to assure that lands will be put to profitable uses, disposal policies should follow a well devised and directed plan.

Only after this planning step is the government really prepared to make an orderly and businesslike disposition of its property. For example, it may be determined that the only hope for restoring productive uses in a given area is to put the land into the hands of some public forestry agency, equipped to do the necessary reforestation and forest management job. On the other hand, it may be found that huge blocks of land are primarily adapted to extensive grazing,

and should perhaps best be transferred to the control of a grazing association and earmarked for grazing use, under such restrictions as would insure the restoration and conservation of the sod. Again, the sensible procedure in area X might be to consolidate several inadequately sized blocks of tax forfeited land into one unit before transfer to some farmer, because only farm units of relatively extensive size could hope to yield an agricultural livelihood in that area. Finally, many plots in various localities would doubtless be found fit for unrestricted sale as before. The point is not at all that the government would, perversely, go into the business of wholesale land ownership and land management. To the contrary, the point is that the government would adopt the same businesslike attitude toward its property as any sound private enterprise. It would take care to learn the character and condition of its acquisitions and how they might, in the long run, be most profitably utilized—to the government's own ultimate financial advantage and in the interests of the people whom it represents and to whom it is responsible.

More precisely, how would a businesslike administration serve the long term interests of forward-looking land policies?

Agricultural students and conservationists have been searching for a number of years now for public tools that might be used to implement the attainment of needed readjustments. Many devices have been proposed or actually attempted for gaining one readjustment objective or another. Characteristically, these devices take education, subsidy, or regulatory powers as their starting point. But education is a long and slow process; subsidy is expensive; and efficacious regulatory powers are difficult to apply successfully, for a variety of obvious administrative, psychological, and legal reasons. Moreover, public regulation of private conduct is cumbersome, slow to be adopted, and often disappointing in results obtained. Therefore, current educational, financial, and regulatory devices for promoting land use readjustments could be usefully supplemented by other fruitful devices less pregnant with their characteristic shortcomings. Orderly and sound policies with respect to disposing of tax forfeited lands may furnish just such an alternative or supplement. The mere fact of ownership—even though in this case it is gained involuntarily, without outright payment of purchase monies—simplifies and avoids just a lot of the problems of governance, presents an opportunity that the State and localities can ill afford to pass up: particularly since readjustment measures are usually more urgently advocated in precisely those regions where chronic tax delinquency is most persistent and acute.

If the restoration of a forest economy in a cut-over region seems imperative, the existence of large blocks of tax delinquent land there gives government something concrete to start with. Waiting

for private development may be fruitless, for rarely is a private concern buying cut-over land as an investment for forest culture.

If it is felt that a basic problem in the area economy is the inadequacy of the size of holdings, the state's possession of numerous plots of tax forfeited land may present it an excellent opportunity to follow a policy of systematically adding to existing holdings, so as to create tracts of sufficient size to support those who gain their livelihood from the land. If the state is sure that certain farming and erosion control practices are essential for the long-term stability and for the tax paying capacity of the area, its status as owner gives it the power of placing restrictions in the lease agreement or deed of transfer such as will insure that the tract remains, for a reasonable period of time, in a solid holding and subjected to a system of sound farm management.

If policy-makers deem essential the reestablishment of a grazing economy in semi-arid areas that have been mistakenly put to the plow, public ownership of tax forfeited lands enables the government vigorously to advance the readjustment—in the interests both of private enterprises and of its own revenue resources—without waiting for economic forces to slowly and finally work themselves out, and without having to wait exclusively until control or subsidy or promotional policy directed at private individuals have borne their hypothetical results.

In grazing and forest areas, particularly, the influence of far-sighted public administration policies with regard to tax forfeited lands, should indeed be a positive aid to those tenacious private enterprises and operating units yet remaining in the area. For example, in grazing areas much help would accrue to local stockmen through state and county cooperation with their local grazing associations—by giving them control over extensive acreage of tax forfeited lands (often abandoned by absentee owners), under such agreements as would insure the fruitful use of the lands and their effective integration into the private grazing economy of the region. Professional foresters could tell you how sound state land management policies could powerfully influence the development of good forestry on the surrounding private holdings.

On the other hand, of course, the adoption of such policies puts a new responsibility on the state—a responsibility which would entail new administrative and financial problems. Nevertheless, if soundly carried out, they should pay handsome social and financial dividends in the long run.

A planned policy for the administration of tax forfeited land may even furnish an implement to mitigate acute local government distress. Under present policies, tax delinquent lands often not only bring no tax revenues, but they produce no revenues whatsoever—lying in a state of idle abandonment, free to be abused by any and all who care to trespass. Only after effective ownership control has

been established by someone can the productive capacities of the land be restored and ultimately made to yield the increased revenue both needed and possible. Moreover, the vigorous exercise of rights of ownership may give the government opportunity to simplify its services and to reduce its overburdened expense budget occasioned by the maintenance of uneconomical roads and scattered schools in a sparsely settled country.

It may be well to sketch some of the major administrative and statutory elements which seem prerequisite to a business-like, far-sighted handling of the tax-delinquent land problem.

First, the state, as contrasted with the local government, has a particularly large responsibility. This is so regardless of whether delinquent land forfeits to the state or to the county or municipality. This responsibility needs to be discharged not only through the enactment of appropriate statutes, the establishment of land programs, but, as well, through providing leadership to the localities and making use of superior administrative organization and superior financial status to get the job done—whether through the medium of a state agency or of a local agency. At the same time, I do not want to minimize the important role that local people and local governments can, and ought, to plan in the process.

Second, one bedeviling obstacle often in the way of achieving a sound and positive policy with respect to tax forfeited lands, is the peculiarly confused status of tax titles. Characteristically, tax forfeited lands, particularly of the marginal and submarginal variety, are as I have said before, a kind of "no-man's-land," the exact ownership of which is confounded by many conflicting claims and half-claims. The typical worthlessness of tax titles, should the former owner or other interested party press the question before a court of law, is a commonplace in legal circles. Before the state and local governments can take confident action with respect to tax forfeited property, therefore, it is necessary that their rights to ownership and possession are reasonably certain. This means that present statutes governing the taking of tax forfeited property need to be so revised and amended as, first, to produce a certain title in the government, and, second, to get this certain title inexpensively, without needless delay, and through such feasible procedures as state and local officials may be expected to follow successfully. I am not stating here what is merely a hope, a generality—this is quite possible and beginnings have been made toward achieving it in several states.[1]

[1] See the Special Report, Department of Agriculture, *State Legislation for Better Land Use*, Chapter 6, "Procedure for Rural Tax Delinquent Lands", and the forthcoming National Resources Planning Board Report, *Tax Delinquency and Rural Land Use Development*, for detailed suggestions treating these problems.

Finally, it is necessary that a suitable administrative apparatus be provided—equipped with the power to classify land and to establish such policies of disposing of land as will make the classification effective. This apparatus could satisfactorily take any of several forms—depending on the customs and desires of the particular state. California uses the comptroller's office; Arkansas, a special commissioner as part of the State Planning Board, and closely tied in with the constitutional state land office; North and South Dakota have provided for the use of existing county government machinery, and so on. The essential elements are: (1) The power to plan and to act in accord with plan; (2) an organization at the policy forming level, so constituted as to have the inclination, time, and savoir faire for making necessary analyses and decisions; and (3) an administrative staff to afford qualified personnel sufficient, with help from the well equipped number of existing federal and state planning and agricultural agencies, to make necessary investigations and appraisals. These suggestions may seem simple and obvious but experience reveals their lack even where intent of a land policy may be professed.

To recapitulate, the statutes must assure that the government gets ownership and possession; that it gets such possession without unreasonable delays, inexpensively and through feasible procedures; that land once taken, shall not be disposed of until it shall have been properly classified; and that it should not be disposed of except in accordance with specifications laid down by informed administrative authority.

A number of states have already gone ahead with taking stock of their traditional policies, and devising more or less superior ways of handling their tax forfeited lands. For purposes of illustration—and without prejudice to progressive policies of other states—I should like to cite to you the so-called Land Policy Act passed by the Arkansas Legislature in 1939 and further implemented in 1941. I think that Arkansas is an apt example because it illustrates that a state does not necessarily have to be afflicted with a nationally notorious tax delinquency problem to learn the advisability of a business-like policy. This act establishes a land use commission, charged with responsibility for appraising and classifying state tax forfeited lands prior to their disposition, and furnished with a staff of five " appraisers " and the services of the state land office for needed administrative personnel.

In the past, Arkansas state lands were sold at a flat rate of one dollar per acre, regardless of true worth, to anyone who cared to pay. Moreover, almost any Arkansas citizen could homestead any available 160 acre tract of undeveloped land on the payment of a $10 fee. Under present policy, however, no land is sold except at its real appraised value. In one recent case, this was $40 an acre. Moreover, no land is sold for farming purposes except in tracts

large enough to support farm operations or except that it be of such quality and character and location as it is believed would lend itself to successful farm operations, and without entailing undue public finance outlays for uneconomical local government services. Under present policy, no one is permitted to homestead except needy applicants who upon investigation show their capacity to become successful farmers.

In its administrative policy, the land use commission is making a studied effort to use the state's tax forfeited lands to promote farm readjustments possible through planned distribution of these lands. The land policy act might thus be used as one wedge to help pry Arkansas farmers away from the one-crop cotton system to which so many of them are now enslaved; as a method for promoting diversification and the live-at-home program, about which the tubs have been thumped so loudly these many years; as a device, for example, for encouraging extensive livestock farming and of promoting farm-forestry in areas where these enterprises seem to afford a prospect for Arkansas agriculture.

On the other hand, state lands unsuitable for agriculture, or uneconomically located with respect to government services, will be set aside for development as public forests, wayside picnic grounds, recreation areas, game and bird refuges, or for whatever other purposes they seem in any given instance to be most suitable—and depending upon the willingness and ability of public administrative agencies, whether state, federal or local, to take over, develop and manage them for these purposes.

Arkansas has, moreover, accompanied the development of this commonsense administrative machinery with a statute which, it is hoped, will help clarify the tax title situation.

Throughout this whole policy runs a thread of whole-hearted cooperation with all other state and federal agencies having similar objectives. The consultation and help of county extension agents, local planning committees, Soil Conservation Service personnel, and so on, is constantly solicited; and a vast amount of cost-free service particularly in land classification activities is available from these sources. Again, word has come that the land use commission is in process of making arrangements with the Farm Security Administration for transferring a large block of tax forfeited land for use in that federal agency's tenant purchase and rural rehabilitation program.

This land is fertile, potentially fine agricultural land, lying along the Mississippi River. In its present state it is not fit for farming because it needs drainage and clearing. As the plan materializes, the state will do its part by furnishing the land; and the Farm Security Administration will do its part by making the capital outlay necessary to prepare the land for agricultural purposes. Development projects in this alluvial area will serve the purpose of provid-

ing an outlet for hill farmers unable to make a decent living on the slopes of the Ozarks, and for those displaced by military cantonments and national defense developments in other parts of Arkansas.

There are other states in which programs worthy of discussion and emulation have been adopted, but time will not permit elaboration.

States such as these by taking a realistic, farsighted, hold of their problems, are showing all of us a provocative answer to the perplexing question: We have got a lot of tax forfeited land, what in the world are we going to do with it? In a day and age when state's righters view with alarm the ever-more greedy spread of Uncle Sam's tentacles, here is one field wholly within state jurisdiction in which vast progress is possible.

TAX DELINQUENCY ON THE RURAL-URBAN FRINGE

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VACANT LOTS ARE THE PROBLEM

The vacant lots in surplus subdivisions constitute the outstanding tax delinquency problem in the rural-urban fringe. Various studies demonstrate this point rather conclusively. In the municipalities surrounding Detroit, 98 percent of the lots included in the tax sale for the years 1932 to 1935 were vacant lots.[1] In the towns surrounding Buffalo it was found that 94 percent of the delinquent properties were vacant land.[2] In the tax sale lists in almost any of our major metropolitan areas it is the vacant lot which accounts for the pages and pages of tax delinquent properties.

The number of vacant lots which find their way to the tax lien register reaches a staggering total. In the Detroit area there was a total of 365,000 lots in the tax sale. Most of these were bid in by the state. In Portland, Oregon, most of the 12,000 properties to which the city has taken title are vacant lots. In addition almost all of the 9,600 properties to which Multonomah County is now acquiring title, are also vacant lots. About two-thirds of these lots are within the city limits of Portland and the others in the area beyond.[3] The State of California has taken title, through tax sale to about 90,000 properties in Los Angeles County. One-third of these are

[1] Michigan Planning Commission, *A Study of Subdivision Development in the Detroit Metropolitan Area*, June, 1939.

[2] Philip H. Cornick, Division of State Planning, New York, *Problems Created by Premature Subdivision of Urban Lands in Selected Metropolitan Districts*, 1938.

[3] Frederick Arpke, Associate Agricultural Economist, Bureau of Agricultural Economics, Unpublished data collected for a study of the Portland Fringe Area.

within the city limits, another third within the other incorporated municipalities and the remainder scattered throughout the county. It is needless to say that almost all of the 90,000 properties are vacant lots.

A map with the tax delinquent properties mapped "in place" would show that they are concentrated chiefly in the undeveloped fringes beyond the built-up sections of our cities. Their concentration would be in direct proportion to the number of undeveloped lots. Such areas often become permanently "blighted" and are not developed even where there is need for additional home sites to accommodate the growing population. Tax deeds are not considered very secure and therefore home builders hesitate to buy such land for home sites. For this reason real estate men go further out into the country and subdivide additional acreage.

The arrested community development in the blighted areas is undesirable from the standpoint of both private and public welfare. The individuals who constructed homes in the area before it became blighted usually have their homes scattered throughout this subdivision. The per capita cost of public improvements and services is high and the residents cannot be certain that they will be maintained. Also the resale value of the properties is lowered. The taxing district will be adversely affected not only in having lost tax income from the abandoned lots but the lowered values on the improved properties will necessitate an accompanied lowering of assessments.

TAX DELINQUENCY AN INDICATION OF TROUBLE

The accumlation of tax arrears usually is an indication that there is maladjustment in ownership and land use. In the rural areas we find tax delinquency to be a problem where people are trying to farm land which is not suited to intensive agriculture. Much of the cutover forest areas are tax delinquent and abandoned because there is little indication that the future returns during the lifetime of an individual will warrant the expense of keeping the property. Likewise in the rural-urban fringe it is the property which has little possibility of future development that is abandoned. Private ownership is discouraged because of the high cost of holding the property and the limited possibilities of using it for any productive or consumptive purpose.

The property tax in some instances may in itself be a contributing factor to tax delinquency. This is especially so with low valued properties because of the widespread tendency towards regressive assessment.[4] Low valued properties as a rule are assessed at a higher level than high valued properties. This would not be a prob-

[4] Joseph D. Selverhers, Special Report of the New York State Tax Commission, the *Assessment of Real Property in the United States.*

lem if the mount of taxes per unit of land were only a nominal figure. However, property taxes have increased several times since 1900. In most states taxes on farm real estate have increased 4 to 6 times since that date.[5] In the present rural-urban fringe taxes have increased much more. In the Portland fringe area the tax per acre of land has increased 20-fold since 1900. Assessments as well as tax rates have increased in the fringe areas.

Taxes on low valued properties have reached a point where the annual tax alone is equal to or exceeds the expected annual income from the property. If an owner of such property is unable to pay his taxes for a period of 2 or 3 years because of economic depression or personal misfortune, he will find that it will cost him more than the purchase price of the property when he finally becomes able to redeem it. When taxes alone reach such a high proportion of the purchase price the rich as well as the poor will abandon properties so affected.

Chronic tax delinquency, then, is not entirely a tax problem. It is a tax problem to the extent that the low valued properties are over-assessed or to the extent that high property taxes contributed to abandonment of properties. Maladjustment of type of ownership and land use are the basic problems causing delinquency in most areas where it is widespread.

EFFECT UPON FARM PROPERTIES

The tax delinquency problem in the rural-urban fringe is rural as well as urban in its effect. It is rural to the extent that farm properties in the same taxing district are affected by the higher assessments and higher tax rates. In the municipalities where public funds have been spent for improvements in defunct subdivisions, the entire tax load has been shifted to the other property owners in the taxing district who do pay their taxes. This puts an additional burden on the land still in farms and may reach a point where the owner is forced to offer his farm for sale to real estate speculators.

It should not be inferred that low property taxes would stop the abandonment of low valued property. In the rural-urban fringe especially the number of vacant lots greatly exceeds the probable future demand for years to come. When the number of lots so greatly exceeds the present and future needs, any cost no matter how small is too great to maintain ownership. In fact if one were to acquire such lots as a gift they should be accepted only if accompanied with some sort of annuity with which to maintain ownership.

SPECULATIVE SUBDIVISION OF LAND

Activity in urban and suburban real estate is not a recent phenomenon. John Locke, living in the 17th century, observed that "in

[5] Bureau of Agricultural Economics, U.S.D.A., May, 1941, *Agricultural Finance Review.*

places wherein manufacturies have erected themselves, land has been observed to sell quicker and for more years purchase than in other places."

In all our metropolitan areas subdivision of land into building sites has proceeded far in advance of the growth of population. In the Detroit area the population increased by 479 percent from 1900 to 1930 but the increase in the number of lots subdivided was 1105 percent.[6] Anyone who has driven by automobile to Chicago or around any major city will have observed the many subdivisions which are only partially, if at all, developed. There has been too much optimism on the part of both the subdivider and the general public. Most of our metropolitan areas now have sufficient lots to accommodate any normal increase in population for years to come but the subdivision of new tracts is still proceeding as though there were a shortage of land.

It is human nature to barter and trade. People will deal in land just as they do in commodities, stocks and bonds. If trading in land could be carried on extensively without an actual transfer of title and without a change in land use there might be a lessening of the number and severity of public problems created. Worthless stocks as a rule merely repose as souvenirs in the hands of the buyer. Abandoned lands, on the other hand, cause a problem of public finance after the owner has decided that his deed to the property is to become a souvenir. The community at large has much at stake in the direction of development which results from widespread transfer of title to land.

If individuals as well as public officials had exercised sufficient foresight and if adequate control laws had been available, it is very likely that the amount of land now held by municipalities due to tax forfeiture would never have reached its present high proportions. We are now faced with a situation, however, and the job is to correct the problem which has been created and also to prevent its recurrence in the future.

EQUITABLE ASSESSMENT

Since excessive subdivision is the cause of the present tax delinquency problem on the rural-urban fringe, measures must be taken which will reduce the extent of this activity.

One solution to this problem would be to assess land at a rate based on type of use. On this basis agricultural land would be assessed at a low level and the tax burden would be in line with agricultural land farther out from the city. This would be an encouragement to keep land in agricultural use until it is actually needed for residential and urban purposes. In order to make such a plan workable it would be necessary to coordinate the assessment

[6] Michigan Planning Commission, *A study of Subdivision Development in the Detroit Metropolitan Area*, June, 1939.

policy with a "master plan" for the taxing district. Otherwise speculators would buy up the farm land and merely lease it to farm operators so as to be able to sell at a profit when a new real estate boom appears. If there is to be a lessening of the tax burden for the purpose of keeping more of the land in farms, there must be a definite limitation on the amount and rate of subdivisions.

It is quite certain that the high tax load on real estate has forced many owners of farm land in the rural-urban fringe to sell their lands to subdividers or to real estate speculators sooner than they would have if the tax burden had been more in line with that in the more strictly rural areas. A quarter section of land located four miles out of the city limits of Portland, Oregon, is a good illustration of the tax cost of holding land for resale. The land is now in brush and therefore it has not yielded any income since the timber was logged off. The taxes on this 160 acre tract of land were $65.20 in 1890. In 1910 they were $163.20, in 1930 $780.52, and in 1940 reached a high of $822.73. The 1940 tax was $5.33 an acre.[7] An owner cannot hold land very many years and sell at a profit when the ripening costs are so great. Resale for agricultural use is not possible because such prices would not be sufficient to yield any net return above costs and original purchase price. Since site value of land is so much higher than agricultural value, the owner will be forced to sell the land in small units for site purposes. The consequent excessive supply of lots for residential purposes will inevitably result in abandonment of numerous new tracts of land. By this process the taxing district will find itself owner of the major portion of the original tract of land, and the tax receipts will be less than that levied on the tract before it was subdivided.

DEVELOPMENT OF A LAND POLICY

The immediate problem with which tax and municipal officials are faced is knowing what to do with the thousands of lots which have been abandoned for taxes. One of the greatest obstacles to working out a solution is the acquiring of marketable title to the forfeited land so that adequate disposition may be made of it. The rising cost of government and the high tax on real estate has made the problem particularly acute in recent years. It is probable that this relative newness of the problem is responsible for the lack of adequate corrective measures in most of the states.

After realizing that enforcement of tax collection would not correct the problem of chronic tax delinquency, several states began working out solutions of a more basic character. Very few states have as a part of their collection procedure a simple and inexpensive process by which marketable title may be acquired by the taxing dis-

[7] Frederick Arpke, Associate Agricultural Economist, Bureau of Agricultural Economics, Unpublished data collected for a study of the Portland Fringe Area.

trict. The taxing districts as a rule do not want to acquire land which has become tax delinquent. The philosophy has been that all land that became tax delinquent should be returned to private ownership. Individuals, however, do not bid at tax sales on the type of lands which are chronically tax delinquent because their low value does not warrant the usual cost of foreclosure. In most states the taxing districts are required to use the same costly foreclosure procedure on tax delinquent land as individuals use on more valuable properties. For this reason some of the recent legislation on this problem has been to permit taxing districts to acquire title by procedure in rem, instead of by the costly procedure in personam. New York State has enacted such enabling legislation and the State of Oregon has made it a part of the tax collection procedure. Other states have enacted such legislation or are considering doing so.

Since the property tax is by definition an in rem tax it seems reasonable that foreclosure in rem should be a part of the tax collection procedure. If property taxation is based on the property's "ability to pay" there is no reason why it would not be just to consider the property only when dealing with tax delinquent properties. The in rem procedure would not be an injustice to the delinquent owner because it would apply almost entirely to the types of properties which owners have already decided to abandon.

When such enabling legislation has been enacted the local officials have an opportunity to develop a land policy which will reduce the quantity of tax delinquent land and which will be a benefit to the community. The in rem foreclosure will give the taxing district marketable title at low cost and set the stage for adequate disposition of the properties which, by being chronically tax delinquent, have been in a state of ownership which is semi-private and semi-public. It would be a mistake to offer at public sale all of the lands acquired through tax forfeiture. "Get the land back on the tax roll" is the common philosophy whether or not the land has any possibility of productive private use. The transfer of many parcels of tax delinquent land back to private ownership will only lead to further private losses and eventual return of the land to the tax lien register. Municipalities which have a serious problem of tax delinquency need to take an inventory of the delinquent land and to relate the disposal of it to the general need for land and the adaptability of the major land areas. Areas which are submarginal for any existing private use or which can be used to better advantage in public ownership should be designated as public purchase areas. Title to any land which becomes tax delinquent in such areas should be retained by the municipality and developed for public use. By following such a policy all the land not suited to private ownership will eventually be transferred to public ownership.

Only land definitely suited to private ownership should be offered at public auction and with adequate restriction as to future use.

In many instances where the subdivision layout is bad and the bulk of the lots are tax delinquent the municipality could, over a period of years, acquire ownership to a sufficient quantity of the land to replat the entire subdivision or to reassemble it as acreage. Such tracts could then be sold to private developers or to local farmers. A good program for the disposition of tax forfeited land will not be to get all the land back on the tax roll, neither will it be to get all such land into public ownership. A logical approach is to get the land into the type of use and ownership to which it is best adapted. With the growth of public housing projects many communities may be able to use favorably located tax reverted land for such purposes. Many cities and communities have a program for the acquisition of land for recreational purposes. In some instances such a program is operated by one group and the management of tax reverted land by another group. The sensible thing to do is to coordinate any land acquisition program with the activities of the delinquent lands department. In this way municipalities may acquire lands for public purposes at a lower cost than if all the purchases were made outright. At the same time they would be reducing the quantity of problem properties.

SUBDIVISION CONTROL

Subdivision control and municipal planning are difficult to accomplish on the fringe beyond the jurisdiction of the city because the local officials are not familiar with urban problems. If there are no state or county restrictions on subdivision, problems which later lead to tax delinquency may have been created before the local officials are aware of them. Cooperation among municipalities is needed because the city, as well as the outlying taxing districts, have a stake in the development of the rural-urban fringe area.

There are several methods by which it would be possible to obtain control over subdivision in the rural-urban fringe. The simplest and most direct method would be for the city to extend its municipal boundaries so as to embrace all of the surrounding areas which might be needed for future urban development. Most of our large cities have extended their municipal boundaries in the past. This expansion, however, has in most instances been after, rather than before development took place. If the expansion had been previous to development the cities could have given direction to the development of the area annexed.

Another method would be for the municipalities involved to delegate powers over problems of mutual concern to a central government. This has been done in New York City and Boston where the local municipalities keep their political entity but delegate certain functions of government to the central unit.

Still another method could be to set up a regional planning board with the authority to develop a master plan for the physical develop-

ment of the entire metropolitan area. Such a master plan could then serve as a guide to the municipalities which adopt it as their official plan and its enforcement and administration carried out by the regional planning board. In instances where the county or other political subdivision outside the city has no interest in planning, it might be feasible to give the city extra-territorial powers over subdivision and the extension of public improvements and facilities into the fringe area beyond the political jurisdiction of the city.

It should be recognized that it will take more than minimum requirements for streets and other facilities to effectively give direction to subdivision development. Some standards based on the need for new subdivisions must be injected into the approval process if we are to reduce the amount of excessive subdivision.

IN CONCLUSION

The tax delinquency problem on the rural-urban fringe is one which cannot be solved by any 5 or 10 year plan of installment payments; neither can it be solved permanently by having more rigid enforcement of tax collection. It is a many-sided problem and one which requires a multiple program of correction. Four programs of adjustment are needed to solve the problem: (1) It will be necessary to have more effective control over subdivision. Such control, however, should not be so rigid as to stifle private initiative. (2) As long as property taxes are a major source of tax revenue an attempt should be made to assess properties on a basis of "type of use" so as to have more equitable assessment. (3) A definite land policy must be developed for the disposal of the tax forfeited lands now held by the municipalities. (4) Since the property tax itself is a contributing factor to the abandonment of property for taxes, it is important to guard against having property bear too high a proportion to the total tax burden.

APPRAISAL OF SPECIAL FOREST CROP TAXATION IN WISCONSIN

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Land use adjustments seem to be exceptionally acute in the twilight zones between established land uses—the farm-forest fringe, the area between grazing and plow farming and in the rural-urban fringe as indicated in the two previous papers. It is not generally appreciated that the break in land uses on the farm-forest fringe, generally speaking, also means a break in ownership, from private

* The author is indebted for the figures and some of the data to Mr. Philip M. Raup's Master's thesis (University of Wisconsin).

to public.[1] That private investors have lost faith in the use of land for any profitable use when the land falls below the agricultural margin is proved by the mounting tax delinquency on the fringes, and the reversion of this land to involuntary county or state ownership. This means public land management, reforestation, and the supplying of public services for an enormous non-taxpaying area in precisely those section of the Lake States least able to do so.

Tax reversion raises the question of how to satisfy the claims of various levels of government on a given parcel of delinquent land (since only one unit can become its owner), the question of payments in lieu of taxes and the sharing of the income from the land with the other units.

It is against this background that the Wisconsin Forest Crop Law must be appraised, not by itself, but as "one tool in a kit of tools" which has functioned as a means of land use adjustment, land management and the slow and halting reorganization of local governments. Its original objective was to assist and encourage the practice of forestry by private enterprise on the supposition that the general property tax was not suited to forestry in private ownership.[2] As intended to operate, it can hardly be called a subsidy such as the Wisconsin wood lot exemption law frankly is, since the state expects to recover its contributions to local units through a severance tax levied at the time of cutting.[3] The land owner pays 10c an acre, representing a tax on the land only, and the state pays 10c an acre, the 20c going to the towns to be divided as follows: 40% to the town, 40% to the school districts (in proportion which the forest crop lands of the district bear to the total forest crop lands of the town) and 20% to the county.[4] The land owner can thus be said to pay part of his taxes annually in the usual manner, the rest being deferred until he harvests his crop, at which time he pays 10% of the stumpage value to reimburse the state for its payments to local units of government. At that time the books are expected to be balanced.

The law, however, is set up to promote commercial forestry. The Conservation Commission is empowered and has the duty to ex-

[1] The National Resources Board Report, December 1934, recommends that by 1960 the 615 million acres of forest land should consist of 358 million acres of public land or 58%, and only 133 million acres in industrial forests in private ownership or about 22%. The remaining 124 million acres of forest land are the farm woodlands. According to the Supplementary *Report* of the Board, Part VIII, p. 57, private forestry is expected to be largely in the South and East, and only a very small part of the area of the Lake States and the West will be in private ownership.

[2] *Wisconsin Statutes,* Section 77.01.

[3] *Wisconsin Statutes,* Section 70.11.

[4] As will be discussed later, because of increased acreage and no increase in appropriation it has been necessary to prorate the state's contribution.

amine the land within five years after entry and reject all land better suited to agriculture, mineral, recreational or other purposes on the one hand, and also land not considered good enough for commercial forestry. It is expected that the stumpage value at the time of cutting will be enough to repay the state for its contribution of 10c per acre for 50 years. That the Conservation Commission has exercised this right is shown by the fact that 112,000 acres of land entered by private operators have been cancelled up to 1941. Some of the cancellations were also due to the fact that the owner was not practicing forestry as called for in his contract with the commission.

From the standpoint of stimulating forestry on all land submarginal for agriculture, it is clear that the forest crop law was intended to assist forestry only on that portion capable of raising merchantable forest products which will bring returns sufficient to reimburse the state for its 50 contributions of 10c per acre. The law cannot be applied to submarginal forest land, and because such land is submarginal for practically all private uses it will tend to become public property via tax delinquency.

During the early years of the forest crop law entries were very encouraging. In 1928, 166,760 acres were entered and by 1932 a total of 292,947 acres was reached. Since then the new entries have fallen off and withdrawals and cancellations have reduced the figure to 150,075 acres. A small proportion consists of merchantable timber entered under the "special classification" provision under which the owner pays annual taxes and severance taxes according to special rates set up in the law.[5] Two lumber companies and three paper mills own 71% of the private forest crop lands and if all the holdings of over 1,000 acres are totalled they represent 81% of all such lands. An encouraging feature is the fact that the lumber company which holds one third of all forest crop lands is practicing model sustained yield management, but others are "cutting clean" and are using the law to help carry their tax load. Paper companies, however, are anxious to build up reserves for the future and have done a substantial amount of planting.

Whether the forest crop law has accomplished its original purpose of encouraging sustained yield management on matured timber and of "reproducing and growing for the future adequate crops of forest products on land not more useful for other purposes" depends on the point of view. Surely there is more land than 150,075 acres in northern Wisconsin suitable for private forestry under the definition of the act, yet it has not been entered under the law. However, the effect of the law is more widespread than these figures would indicate. Trees are being planted and forestry practiced on land not entered under the law. The operators can always fall back on entry whenever general property taxes rise too high. The cancellations,

[5] See Subsection 5 of 77.02: 2 of 77.04 and 5 of 77.06 of the *Wisconsin Statutes.*

withdrawals and tax delinquency on forest crop land can also be cited as evidence to show that even after the land had been entered, private individuals lost their enthusiasm or failed to practice forestry as was the intent of the contract they made with the state.[6]

The reasons given for the failure of private owners to make more use of the forest crop law are varied. One reason is that in many parts of the North the tax burden on land classified as "marsh, waste and cut-over" is now so low that there is less incentive to take advantage of the 10c maximum provided by the forest crop law. Perhaps with changed conditions modifications should be made in the law so as to make it more attractive to woodland owners. On the other hand, experience with forest crop laws in general seems to indicate that taxes are not the deterrent to private forestry that we once thought they were. The failure of private owners to practice forestry must be laid to other causes. Now that the obstacles of fire and taxes have been met the chief economic stumbling block is probably the need for long-term low-rate credit similar to that provided for agriculture. However, lumber companies, who though under the forest crop law are clear cutting, claim that the overhead of a large mill and extensive equipment is such that the only economical practice is to cut out as rapidly as possible. With the constantly growing areas of publicly owned forest land, many timber operators and other wood users also feel that their future supply of timber is secure, and therefore it is not necessary for them to engage in forestry on their own lands.

Whatever may be the verdict in regard to the success of the forest crop law in getting land into forest use under private enterprise, the law has been a marked success in helping to establish forests on county owned land. Counties were reluctant to take title to the millions of acres of land that became tax delinquent after 1920 in the cut-over region. The first reaction, which still persists to some extent, was to get the land back on the tax roll. However, private owners refused to redeem their properties and investors failed to buy tax certificates. The reluctance of the county officials to take title was rational. The land was thereby removed from the tax base of the state, county, towns, and school districts, but their unwillingness to take title to tax delinquent land was tempered by the fact that by so doing they removed fictitious assessment valuations, reduced excess delinquency, and facilitated budget making.[7] Never-

[6] Tax delinquency on forest crop land has averaged about 12% since 1935. Since the state does not pay its 10c. per acre until the private owner has met his tax obligation, the local units of government do not get any revenues from delinquent forest crop land.

[7] This is due to the fact that the county in Wisconsin is the "residual claimant" of property taxes, and because of its peculiar position in the "public finance structure." See "Making the Most of Oneida County Land," Extension Service of the Wisconsin College of Agriculture, *Special Circular*, April 1931, p. 22-24.

theless, ownership involved land management, putting it in a productive use, guarding it against trespass and providing the area with public services. This in turn meant additional funds, personnel and technical knowledge for the counties with the smallest financial resources for such tasks. The forest crop law helped to solve this problem.

Since 1928, at first under a ruling of the Attorney General and after 1929 by an amendment to the original act, the Conservation Commission has accepted county owned land for entry under the law. The state pays the usual 10c per acre to the towns divided on the 40-40-20% basis, but the county does not pay the 10c an acre required of the private land owner nor is it subject to "back taxes" whenever it withdraws its land from entry.[8] On the other hand, the county is subject to a 50% severance tax instead of the 10% paid by a private entryman because of the forestry aid law to be discussed presently. The other features of the law are much the same; the county is expected to practice forestry and the Conservation Commission has the right and duty to reject submarginal forest land, land poorly blocked up or which in other ways fails to meet the standards set by the commission. It should be pointed out that none of the three levels of government is obligated to spend its proportion of the forest crop money, whether paid on county or private land, for forestry purposes. Furthermore, the county gets only 20% of the so-called "payments to the towns" yet the entire burden of managing tax-reverted land for forests or recreation falls upon the county.

To assist counties in their forestry work an act was passed in 1927 providing for the establishment of county preserves, and outlining the powers of county boards. This law was amended in 1931 to provide for the payment of 10c per acre per year on all forest crop land in county ownership and in established forest reserves. It should be emphasized that this "forestry aid" money is entirely separate from the state's contribution to the towns under the forest crop law, that it comes out of another fund entirely, and is earmarked for "the purchase, development, preservation of such (county) forest reserves." These two complementary laws are the basis for county forest management or more correctly *cooperative* forestry in Wisconsin. They have stimulated counties to take title promptly to tax-reverted land and have given to the counties the necessary funds, personnel and technical knowledge for efficient forest land management. In 1931, 133,492 acres were entered by the counties, but the

[8] Counties can withdraw land entered under the law. "However, when voluntary withdrawal and sale of forest crop lands results in breaking up well blocked county forests the conservation commission shall deduct from the next payment of state contribution to the town within which such lands are located, the amount previously paid on the withdrawn lands." (*Wis. Statutes* 77: 13.) This deters but does not completely stop counties from withdrawing land.

heaviest entries were made in 1932 and 1933. At present the total acreage of county forests operating under the two laws is 1,883,000 acres, an area approximately equal to the gross area of the federal forests within Wisconsin. At present 25 out of the 27 counties owning forest crop land have met the requirements of the forestry aid law and by January 1, 1941 the state had paid over a million dollars in forestry aids to the counties. It should be noted that mere entry under the forest crop law by itself does not make the land eligible for the forestry aids. Furthermore, not all tax-reverted land is automatically eligible for entry under the forest crop law. The Conservation Commission rejects land not suitable for commercial forest production or cancels entries if the provisions of the forest crop law or forestry aid acts have not been carried out. Almost 123,000 acres of county forest crop land had been cancelled by 1941. This means that the forest crop law is limited in its ability to assure forest management on all land submarginal for agriculture and reverting to the counties for nonpayment of taxes. By 1941, the northern Wisconsin counties had taken title to about 3,000,000 acres of which 1,883,742 acres were under the forest crop law and eligible for forestry aid. Part of this discrepancy is due to the policy of counties not to enter all their land because they hope to sell it or use it in other ways, but by far the larger area is not acceptable under the law (principally because of "blocking requirements"); therefore the forest crop law cannot aid the counties in promoting forestry on about one-third or more of the cut-over region. If forestry is practiced at all it will be highly extensive and under unassisted county management.

Any appraisal of the Wisconsin forest crop law must consider its relationship to the zoning movement. Under the enabling act of 1923 and amended in 1929 to permit counties to zone for agriculture, forestry and recreation, 26 northern and central Wisconsin counties have set up forestry and recreation districts in which the chief prohibited use is agriculture. Under these ordinances about 5 million acres or 1/7 of the area of the state is closed to agriculture. While forestry and all other legal uses are permitted in the "unrestricted" district, forestry, mining and seasonal recreation are the only permitted uses in the restricted districts.[9] A very significant element in zoning is that a distinct line has to be drawn between farm and forest areas, a line which, of course, can be relocated as conditions

[9] The northern Wisconsin ordinances usually list 11 permitted uses in the forestry districts which are summarized above, but also include hydroelectric dams, power plants, flowage areas, transmission lines and substation, the harvesting of any wild crop such as marsh hay, berries, tree fruits, etc. Nine counties have separate "recreation districts" involving about 267,000 acres which permit family dwellings in addition to the permitted uses of the forestry district. The ordinances also state that their provisions shall not apply to buildings, land or premises belonging to the United States, the state, any town or school district.

change, but nevertheless a line representing a definite cleavage between the two land uses in contrast with a shadowy transition zone.

Merely passing an ordinance, however, will not make trees grow in a forest district even though it is so named and colored a beautiful green on a map. The owner of land in a restricted district may be interested in farming and not in forestry, or his holding may be too small for this purpose, or as a land dealer he now finds that the sale for permitted uses is severely limited. However, both the forest crop and the county forest laws permit the exchange of such land with county owned land outside of the restricted district. This feature has also been used in abating non-conforming uses. For those who are forest-minded the forest crop law acts as an incentive to use the land for this permitted use. The law has given real stimulus to the counties to take title to the tax-reverted lands and practice forestry upon them. Additional impetus has been given to zoning by the policy of the Conservation Commission of giving preference to land lying in the forestry districts set up under zoning ordinances in accepting land for forest crop entry. This policy has also strengthened the feeling of local residents that forestry is not a temporary land use but that the land in county forests and in the forestry districts is definitely dedicated to forestry under land management. Furthermore, close cooperation in the administration of zoning and of county forests is secured by placing both responsibilities in the hands of one individual, in the majority of cases, the county agent, in others county land managers have come into the picture.[10]

To complete the list of land use adjustments associated with the forest crop law, mention should be made of the state and federal forests and their coordination with county forests. To the extent that the land within a restricted district is converted into public land dedicated to forests the administration of the zoning ordinances is simplified. Also the entry of the privately owned land under the forest crop law stabilizes the use and ownership of the land and there is less danger of the land being used or sold for illegal purposes. The exchange of land and resettlement of non-conforming users likewise remove the temptation to violate the zoning ordinances.[11]

While it can be argued that local units of government should be dissolved, changed or consolidated as the result of land use adjust-

[10] See Philip M. Raup, "An Example of County Land Management; Lincoln County, Wisconsin." *Journal of Land and Public Utility Economics*, May 1941, p. 233-238.

[11] The above does not complete the list of land use adjustments. The federal government has carried out an extensive resettlement program, counties have done some "resettlement" on their own account and other federal and state programs have been coordinated with zoning and county reforestation. See Walter A. Rowlands, "Zoning Stands the Test of Time," *Wisconsin Counties*, Dec. 1940, p. 16 f.

ments and redistribution of population, such changes will come very slowly and only with changes in statutes and constitutions and by overcoming the resistance of local inhabitants and office holders. Local governments are dependent to a high degree on taxes derived from land, and every encroachment of public ownership reduces their means of support. This is usually compensated for by grants in aid and by sharing the income from the resource in public ownership. The policy of the federal forest service is a case in point. The Wisconsin forest crop law has automatically acted in this capacity. The state contribution divided among local units of government was designed to reimburse them for decreases in taxes whenever the land was entered under the law.[12] The same units share in the severance taxes after the state is reimbursed and in the "back taxes" on the same basis as they share in the 10c per acre forest crop money.[13]

The forest crop law is unique, however, in that the state expects to be reimbursed for all payments made to local units out of the severance taxes paid by individuals and counties. It should be noted that of the 50% severance tax paid by the county on timber cut from forest crop lands on which the state has paid forestry aid, only one fifth is divided as is the 10% severance tax paid by private individuals; four fifths is restored to the forestry fund from which the aid was originally paid.[14]

It has been feared that forest crop money would prove sufficient to keep alive unnecessary units of government—that towns, for instance, with large areas of forest crop land and small population could comfortably live off forest crop payments. However, this is

[12] The first section of the law (77.01) states that the purposes of the act shall be carried out "in such a manner which shall not hamper the towns in which such lands lie from receiving their just tax revenue from such lands."

[13] The state retains an amount equal to the total acreage payments, with interest thereon at 5%, retains all penalties imposed because of delinquent severance taxes, and another 5% of the total acreage payments to cover the cost of administration. (Sect. 77.07). On lands withdrawn by private entrymen, owners are required to pay all real estate taxes which would ordinarily have been charged against such lands, with interest at 5%, less any acreage taxes or severance taxes the owner has paid. From these "back taxes" the state also subtracts all taxes paid to the towns with interest at 5%, and the balance is sent to the town treasurer to be divided on the usual 40-40-20% basis. (Sect. 77.10, Subsection 2.)

Up to January 1, 1941 the payments to towns for these two items were $72,163. It is interesting to note that since 1935 the forest crop law lands have yielded almost $23,000 in severance taxes, of which $7,765 has been returned to the towns after the state deducted its share, plus interest and costs of administration. These sums are small for the state as a whole but will increase as timber is cut from the merchantable stands and the cut-over lands come into production.

[14] Sections 77.07(3) and 77.06(5).

not the case so far. Even though the money paid by the state to date is over a million dollars, when broken down by years and units of government the amount received by a given town is relatively small. In the first place, towns retain only 40% of the forest crop taxes and secondly, since 1935 the state has not paid the full 10c. per acre.[15] A study by Mr. Philip Raup of eight towns with exceptionally large acreages of forest crop land indicates that in the most extreme case where 91% of the area was entered under the law the town received $1,324 from forest crop payments but the cost of town government was over $3,000. Other grants in aid were so high that forest crop moneys were only 45% of all the aids the town received from the state and county. Put in other terms, the other aids were more important in "keeping the town alive" than the forest crop moneys. In a more typical case, where one half of the town was in forest crop lands, only 12% of total receipts were from forest crop payments. Generally speaking, these payments are of greatest importance to the school districts and of least importance to the counties. However, settler location and the recent law giving the State Department of Education the power to bring pressure on "small" schools are effective means of closing expensive schools, irrespective of possible inducements of the forest crop law. As a matter of fact, a few cases of town consolidation can be traced to the operation of the forest crop law combined with settler relocation and land use adjustment programs.

In summary, it is not maintained here that the forest crop law has fully accomplished its original purposes nor that county land management is everywhere up to the standard set by a few counties or the standard set by state and federal forests at their best. It is believed, however, that the law has demonstrated its place in a "kit of tools" as a means of getting submarginal, tax delinquent land into productive forest uses in private and public ownership, that it has stimulated local pride and initiative in the management of county forests and has assisted local units of government in this

[15] Since the amount of *private* forest crop land is small, only a small number of units divide 20c. per acre, by far the larger number get only the 10c. contributed by the state.

The total sum to be divided is fixed by law, and if the total payments in any one year exceed the appropriations for that year the amount available is prorated. (Sections 20.07(2) and 77.05(2) *Wisconsin Statutes.*) Recent appropriations have amounted to $150,000 per year from which the cost of administration is subtracted before the payments to the towns are made. Payments were made in full through 1935; in 1936 only 8.75 cents per acre was paid and in 1940 only 5.2 cents. The heavy reduction in the past few years was also due to drastic cuts made by the Emergency Board. The local recipients objected to this action of the Board and in 1941 6.8 cents was paid.

The forestry aid contribution of 10 cents an acre to the county is also fixed by statute but has been sufficient to pay the full sum till 1941; this year some reduction is expected.

activity. It has complemented the zoning of land for agriculture, forestry and recreation, furnished a method of payments in lieu of taxes and of sharing the income from cooperative forests with other levels of government. It has not and cannot assist counties in the management of "submarginal" forest land. It is a question whether the act should be amended to be of assistance to counties in this direction or whether additional legislation should not be enacted to take care of this segment of publicly owned land.

APPRAISAL OF SPECIAL FOREST TAX LEGISLATION IN PRACTICE

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Forest tax legislation in the United States began in 1861, just 80 years ago, when the territorial legislature of Nebraska passed a law granting partial tax exemption to land owners who would plant and maintain forest trees under specified conditions. This Nebraska law was the first of a long series of exemption, rebate and bounty laws designed primarily to encourage forest planting, some of which remain on the statute books today. A later version of the Nebraska law was the only one of this type to accomplish notable results. It proved too expensive to be retained.

Forestry in this country is in reality more concerned with naturally regenerated forests than with planted stands. About 30 years ago this fact began to be reflected in forest tax legislation. At that time also, the idea gained acceptance of substituting a yield tax for the property tax on timber, an idea which had been under discussion since the nineties. The first yield tax law was enacted by Michigan in 1911, and was limited to farm woodlots.

Before getting further into the subject, it may be well to note that special forest tax legislation is now regarded as only part of the answer to the forest tax problem; perhaps an even more important part having to do with cost of local government and with property tax administration. It is the legislative phase of the problem, however, which is the subject of this discussion.

Special forest tax laws may be divided into two broad categories, optional and mandatory. Optional laws give the owner the option of choosing between the ordinary ad valorem tax and the method offered in these laws, and usually require him to take the initiative in getting his land classified under their terms. Mandatory laws, on the other hand, allow only one method of taxation on the classes of property to which they apply.

The appraisal of forest tax laws now in effect may well begin with those of the optional type, since these offer the longest record

of experience. Optional laws imposing the yield tax which are applied to 1 percent or more of the privately owned forest area of the state concerned, are found in Vermont, Massachusetts, Idaho, Louisiana, and Wisconsin. Optional laws granting a fixed assessment are in effect in Indiana and Iowa. A unique optional law granting complete exemption to the trees is in operation in Connecticut. In Ohio, a differential rate favoring classified forest property is provided. Experience with these laws will be very briefly reviewed.

OPTIONAL YIELD TAX LAWS

One of the oldest of this type is the Vermont yield tax law which, with minor differences from its present form, was enacted in 1913. Although nearly all forest land in the state is eligible for classification under this law, only about 37,000 acres of private land, representing 21 owners and 13 counties, are now so classified. This amounts to 1.2 percent of total forest area. (All data on classification are as of July 1, 1941 unless otherwise specified, and will soon be available in a mimeographed report by Louis S. Murphy, entitled *1941 Supplement to State Forest Tax Law Digest of 1939.*)

The present form of Massachusetts yield tax dates in the main from 1922. It is one of the simpler plans of this kind, leaving the land apart from trees subject to the unmodified property tax. Precise information on the area classified under its terms is not available, but the indications, based on a canvass made in 1939, are that the classified area is less than 30,000 acres, amounting to around 1 percent of the forest land area of the state and about 1.5 percent of the eligible area, representing, however, over 120 different owners and 12 counties.

The presence of this Massachusetts law on the statute books, in some cases at least, is known to have been used by forest owners to obtain reductions in forest land assessments from assessors who preferred to avoid classification of forest lands in their districts. Such indirect effects are difficult to evaluate, but it is evident that the law has not been satisfactory to the forestry interests, since they are now backing a new measure intended to be of much wider application.

The Idaho law, dating from 1929, has in addition to the yield tax feature a land tax restricted by a fixed assessment of $1.00 an acre. Again precise figures are not available, but it appears that the area classified is probably about 150,000 acres, or around 4 percent of the forest land area and 5 percent of the eligible area. The bulk of the classied land is held by a few large owners. It is probable that this law has not had much influence on their management policies. It was intended to encourage owners to maintain cutover and second-growth forest lands in productive condition under regulations prescribed by the State Board of Forestry.

The Louisiana forest tax law dates back to 1910, starting as a partial exemption and adding the yield tax and certain other features in 1926. A contract establishing the assessed value of the land at a fixed amount between $3.00 and $8.00 per acre is a requisite to classification under this law. The area classified is 550,000 acres, representing 56 owners and 14 parishes or counties. The percent of forest area classified is 3.5; of eligible area, 8.6.

The Wisconsin yield tax law, dating from 1927, has just been discussed and need not be dealt with here. It is sufficient to note that it differs from the preceding laws in that it may be applied to merchantable timber also under what this law terms "special classification". The area of privately owned land classified is 152,600 acres, representing 156 owners and 36 counties. This area includes 9,565 acres under "special classification". The percent of forest area classified is 1.3 and of eligible area 2.5.

OPTIONAL FIXED ASSESSMENT LAWS

The idea of an optional forest tax concession in the form of a fixed assessment at a low rate, the chief feature of the earlier (1910) Louisiana law, is now embodied in the laws of two states, Indiana and Iowa, with fixed assessments for classified forest lands of $1.00 and $4.00 respectively. The Indiana law is applied to a little over 107,000 acres, representing 1,855 owners in 89 counties. The percent of area classified is 3 and of eligible area 15.3, the latter being the highest ratio to eligible area shown by any forest tax law of the optional type. The Iowa law does not make such a good showing in area classified, but an even larger number of owners is reached.

These laws are frankly subsidy and educational measures designed to induce farmers to give up grazing their woodlands and to become interested in productive forest management. They seem to have had some success in attaining these ends, especially in Indiana where the state forester's office is charged with the administration and has made a special effort to exploit the educational possibilities. The weakness of such laws is that the large benefits which they offer in these states where land values are high would be destructive of local public revenues if the laws were invoked by a high proportion of woodland owners. They may be useful in giving an initial stimulus to good forestry practice, but hold little promise for ultimate application to all woodlands of a state.

OTHER OPTIONAL LAWS

There are also a number of forest tax laws of the optional type which offer exemptions of various kinds, usually limited to immature trees, or some form of rebate or bounty as encouragement to specified forest practices, usually forest planting or protection of young forest stands. As indicated before, some of these laws stem

back to first attempts in forest tax legislation. It is difficult to appraise these laws with a high degree of certainty, but in cases where the area classified is available, the quantitative results appear unimportant. In all these cases less than 1 percent of the forest area is directly affected. In general, it is safe to say that exemptions of this kind have accomplished little.

Possibly an exception should be made in the case of the Connecticut exemption law. Here the exemption may include forest trees in natural stands and may continue so long as the state forester is of the opinion that it would be advantageous to the community and to the owner to permit the trees to remain standing until they become suitable to be cut for lumber. The tax concession offered appears to represent a substantial aid to private forest enterprise. The discretionary power vested in the state forester is probably more than most states would be willing to grant. It has been very conservatively used as only 16,259 acres are reported as classified, which amounts to about 1 percent of the forest area of the state.

The only other optional law which deserves special mention is that of Ohio. This measure was passed in 1925 as a yield tax law, but in 1939 the yield tax provision was omitted in an amended version. It now provides a differential in favor of classified forest properties of one-half the ordinary local property tax rate. Aside from the optional feature and some less important provisions, it resembles the differential forest tax plan proposed by the Forest Service in its 1935 report. Since the yield tax feature was dropped, there has been a small increase in classified area which is now about 68,000 acres, 1.5 percent of total forest area and 6 percent of the eligible area, representing 856 owners and 82 counties.

MANDATORY LAWS

Impatience with the slight results in terms of classified area obtained through optional legislation led naturally to a demand for making special forest tax provisions mandatory. Like many other legislative experiments, mandatory forest tax concessions began on the West Coast. The first state to take the plunge was California which, by constitutional amendment adopted in 1926, exempted all immature trees except on lands bearing the original growth timber from which less than 70 percent of all trees 16 inches and over had been cut. The exemption extends until maturity, specified to be 40 or more years from time of planting or of cutting the old-growth timber, as determined by the assessor and representatives of the Boards of Forestry and of Equalization.

Since, when this amendment was adopted, it was not the custom of California assessors to recognize value in young timber stands, their exemption had no immediate effect other than to provide

against the danger of future burdensome taxation of second-growth trees. As this danger has not seemed imminent, it is doubtful if this law has had much influence on the plans of forest owners. Incidentally, it is a long time before the difficult problem of deciding just when these stands become mature and fully taxable must be faced.

The earliest mandatory yield tax laws, and until recently the only such laws, were adopted by Oregon in 1929 and Washington in 1930. Both require that the respective Boards of Forestry take the initiative in classifying eligible lands, with confirmation by the Tax Commission. Both laws substitute a 12½ percent yield tax for the property tax on timber and require that lands to be eligible must be without mature timber in merchantable quantity and must be chiefly suitable for forestry. The principal difference is that the Oregon law imposes a specific tax on the land, 5 cents per acre west of the summit of the Cascades and 4 cents east of that summit, while the Washington law fixes an assessed value of $1.00 on the west side and of 50 cents on the east, the legal ratio of assessed to actual value being 50 percent.

In view of the length of time which has elapsed since these laws were passed, it would be natural to expect that the mandates which they contain, requiring that the eligible lands be classified as soon as possible, would have been to a large extent executed by this time. Accordingly, it is disappointing to find that in Oregon only 16.9 percent and in Washington only 5.7 percent of the eligible privately owned lands are classified. Furthermore, it is evident that for some years the eligible area in these states has been increased through cutting off merchantable timber by far more acreage than has been classified. Evidently something has happened to prevent the fulfillment of the mandates which these laws contain.

For Washington the explanation is simple. The administrative authorities appear to have ignored the mandate to classify eligible lands on their own initiative and in practice have effected such classification only when requested to do so by the owner. Thus, in effect, this law has been relegated to the status of an optional measure, and it is only natural that in extent of application it has followed the characteristic pattern of the optional type.

In Oregon the situation is a little different. The law has always been vigorously supported by the forestry interests, including the State Board of Forestry. Classification began at a fairly rapid rate, naturally enough in the counties where the demand for such classification was especially active. In the first few years after enactment progress was fairly encouraging. Since 1933, however, the net gain in classified private forest area has been only about 100,000 acres, a gain which is especially insignificant in view of the very much larger increase in eligible area over the same period through removal of merchantable timber.

This disappointing result may have something to do with the fact that opposition to the law has arisen from a number of sources. Where taxes on cutover lands are so low under the current property tax that under classification they would be increased, the owner naturally opposes classification. Subsequent to the passage of the law the general level of the property tax in Oregon was lowered enough to make such situations more frequent than could have been originally anticipated. Where the opposite situation exists, and classification under the law gives a substantial tax reduction, county officials and other taxpayers have opposed classification because it reduced local government revenues. Such opposition tends to appear in counties where the tax base has been reduced by depletion of the timber resource and tax rates have become correspondingly high. Furthermore, the requirement of this law that eligible lands be definitely classified as chiefly valuable for growing forests has aroused opposition from advocates of an alternative use for cutover forest lands, more particularly from those interested in promoting their conversion to pasture. It seems reasonable to infer that the administrative authorities have deemed it wise, under these circumstances, to avoid pushing classification under this law too hard where it was not wanted. Otherwise it is difficult to account on any reasonable basis for the meager progress which has been made.

In pointing out the failure of the Oregon and Washington yield tax laws to satisfy the high hopes which were expressed when they were first enacted, there is no intention to represent them as without beneficial results. While no detailed study of their practical effects has been made, nevertheless, many foresters in the Pacific Northwest believe that these laws have exerted an important influence on private owners to retain cutover forest lands and protect them from fire. A recent attempt to repeal the Oregon law was defeated as a result of active support from the forestry interests, including the State Board of Forestry.

WHAT DOES THE EXPERIENCE SHOW?

It is evident from this brief review of experience that not one of the special forest tax laws which have been tested for some years can be considered as a model for an adequate law. Laws of the optional type, with or without the yield tax feature, seem to be inherently destined to a narrow application. Unless the concession which they offer is greater than justice requires and public opinion will long support, no large number of private owners are moved to accept the risk of being set apart in a separate tax category.

The experience with mandatory yield tax laws applicable to specially classified forest lands has been shown to be little better. The faiure of the mandatory feature in Oregon and Washington is connected with difficulties of classifying forest lands as chiefly valuable for forest production, as well as with the inflexible features of the

specific tax or fixed assessment on land and with the yield tax feature itself. The attempt to apply a temporary exemption to be removed at maturity, as exemplified by the California plan, would seem to lead to great difficulty in establishing any method of determining maturity which would be practicable in tax administration.

Furthermore, forest tax plans which are entirely or chiefly applicable to clear-cut lands or to immature trees are based on an inadequate idea of what constitutes good forestry practice. These plans envision forestry as beginning with bare land or with a natural forest from which all merchantable timber has been removed, and ending with the complete harvest of the forest crop. This is precisely the type of forestry which holds least promise, especially for private owners. Light selective cutting of individual trees, or heavier cutting limited to groups or strips, all regulated so as to permit a harvest every year or every few years, is a concept of forestry practice which has only recently been capturing the attention of the public. The application of this kind of forestry to the large areas already cut over is retarded by the necessity of first building up the growing stock in trees to the point where annual or short periodic harvests are possible. Its application to old-growth forests has been stimulated by recent developments in logging technique and recent research showing the economic advantages of restricting the cut largely to trees that yield high value products. Neither exemption of immature stands nor tax adjustments applicable only to clear-cut lands are in accord with this type of forestry practice.

RECENT AND PROPOSED LEGISLATION

The adoption of forest tax adjustments better suited to the above concept of forestry may be foreshadowed by current developments. Although they cannot be appraised on the basis of experience, two recently enacted laws and one proposed law are of special interest.

The Mississippi yield tax law of 1940 is unique because it abolishes the property tax on all standing trees and substitutes a yield tax, allowing no option nor alternative. The yield tax device was adopted by the committee which drafted this law because any one of the special adjustments proposed by the Forest Service in its 1935 report would have required a constitutional amendment. For constitutional reasons, also, the yield tax is called a privilege tax. The rate is 3 percent of value at point of severance. Revenue difficulties in changing from the property tax to this low-rate yield tax are minimized by the fact that under the property tax as administered in Mississippi, only a small part of the timber had been assessed. According to the report of the State Tax Commission, no serious difficulties have arisen in administering the yield tax. Another administrative danger is that assessors will nullify exemption of timber from the property tax by magnifying assessments of land and other

property of timber owners. If this danger is avoided, the law should give definite and widespread encouragement to building up the growing stock on forest land and maintaining it in productive condition.

Another recent law which deserves brief mention is the deferred timber tax adopted by Washington in 1941. Although founded on the deferred timber tax proposed by the Forest Service, it departs rather widely from that plan. It applies only to forest lands which contain timber in merchantable quantities, thus supplementing the yield tax law which applies to cutover lands. It provides for deferment of a portion of the tax on the timber until it is cut, but requires payment of interest at 3 percent annually on the taxes thus deferred. If a parcel is held long enough before cutting, a portion of the tax on timber may be cancelled. Its application is unfortunately optional with the owner, although classification may be accomplished without his making application or otherwise taking the initiative. It is so different from any other optional type of law, however, that its results in practice will be well worth study.

There is one proposed law with definite possibility of enactment which will be mentioned in closing because it embodies one of the Forest Service tax plans in substantially the form in which recommended. At the last session of the North Carolina Legislature a measure was considered which would have given all standing timber in the state the benefit of a differential in assessment, the plan which has been called the differential timber tax. The proposed reduction factor was 50 percent, that is, the timber would have been assessed separate from the land and taxed on 50 percent of its assessed value. It is expected that this measure will be introduced again at the next session of the Legislature with reasonable prospect of favorable action. Actual experience in the application of this plan is much to be desired, as it is the simplest of the three forest tax adjustments proposed by the Forest Service and the least disturbing to ordinary property tax practices.

CONCLUSIONS

It was said in the comprehensive report on forest taxation issued by the Forest Service in 1935, that "while the forest-tax legislation of the past has given valuable experience, it has been chiefly negative in character. As yet it has not developed any law which may be regarded as representing an adequate solution of a positive sort to the forest-tax problem." [1] This conclusion still holds. Subsequent experience has confirmed the difficulty of any plan which requires for purposes of tax administration a separate classification of forest lands on the basis either of desirable use or of management policy. It appears then, that an adequate forest tax law would apply to all

[1] Fairchild and Associates, *Forest Taxation in the United States*, U.S.D.A. Misc. Pub. 218, p. 404.

forest land rather than to some particular class. Also, such a law would be mandatory in the sense that the owner would not have his choice of alternative methods. These requirements preclude, wherever forests are an important part of the tax base, tax concessions which are too burdensome to other taxpayers to win widespread public support. They also indicate that forest tax adjustments should be related to the growing stock in trees and the business of forest management in such a way as to promote productive use of forest lands without relieving them from the necessity of sharing the costs of government on some equitable basis with other real estate. The above-mentioned comprehensive report presents a numbr of possible solutions designed to meet these specifications.

APPRAISAL OF RESETTLEMENT FROM STANDPOINT OF PUBLIC POLICY, INCLUDING EFFECTS ON STATE AND LOCAL FINANCES

O. B. JESNESS
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University of Minnesota

The citizen today finds it hard to realize that the land in this country was not always in private ownership. He thinks of land outside of public forests, parks, highways, and the like as being in or suited for private ownership. Of course, as he goes back over our development and settlement period, he is soon reminded of the fact that land was transferred from public to private hands by means of sale, grants, preemption, and homesteading.

It is easy enough today, from the vantage point of hindsight, to point out that disposal of public land sometimes was influenced too much by developmental enthusiasm and too little by sober calculation of the real prospects for successful utilization of all of the land by settlers. No purpose is to be served by castigating our forebears for having made mistakes. The only reason for calling attention to them is that we have inherited certain problems from the errors of the past and need to understand them if we are to effect improvements.

Sufficient discrimination was not always shown between good and poor land in encouraging and permitting settlement. Almost any sort of land was viewed as being potentially agricultural. The limits to market requirements and growth were inadequately visualized. One result is that we find settlers trying to make a living on land or in areas unsuited for agriculture.

Scattered settlement and attempts to farm not suited for agriculture involve certain public costs. Providing roads, schools, and other public services for isolated settlers involves inordinate outlays. The total tax payment of the settler may represent only a very small

portion of the additional out-of-pocket public expenses which result from the fact that he is in an isolated location. Society loses not only because of these unnecessary public costs but also because the productivity and income-earning ability of the individual often are reduced as well. When costs for public services get too far out of line with the tax base, tax delinquency mounts. This adds to problems of public finance and represents another reason why the public is concerned with isolated settlement.

Information gathered some years ago showed that the special transportation costs for bringing the children of twenty-eight isolated settlers in St. Louis County averaged nearly $186 per family for the previous year. The property tax collections for these families that year averaged only $6.22. The average cost of road maintenance for thirteen isolated settlers was about $91, and the property taxes collected from them were only $7.03. While these are extreme cases, they do illustrate clearly that public costs are significant and the burden has to be carried mostly by others.

John Mason of the Bureau of Agricultural Economics, after making a study of isolated settlers in Koochiching County, Minnesota, concluded that "cash income among isolated settlers, in addition to being low, is derived in large measure from such nonproductive sources as relief, public assistance, and the maintenance of uneconomic services."

Many of us probably have chuckled over stories about settlers who derive their income from transporting their own children to school because they are in such a remote location that it is too costly to send a school bus for them. It is claimed that income from this sort at times has been held up to prospective buyers as an inducement for them to locate in a remote area. Some settlers are paid for work on roads provided solely for their use at public expense. Somehow or other, the humor of this loses its flavor when it dawns on us that the joke really is on the public who pays the bill.

Zoning has been extended and adapted to rural land in areas not generally suited to farming. The direction over land use made possible by zoning is extremely valuable as a guide for future settlement and as a preventive against repetition of past mistakes. Zoning by itself does not remedy existing scattered settlement. This is not saying that zoning may not serve to correct some cases. Settlers in areas in which zoning sets up restrictions to future settlement are given notice in this way of the fact that they are located on land not well suited for agricultural use. This may induce some of them to seek out for themselves a new location in more favorable surroundings. However, the more usual situation is that the settler has all his resources in his holdings and has no alternative but to stay there as long as he can hang on. It is this condition which creates a place for public programs of assistance to such cases. The

employment of public funds for this purpose should represent an investment bringing returns justifying the outlay. The justification is obvious and clear-cut where the savings in public expenses more than balance the costs involved. Each $100 in annual costs saved in this way will represent a satisfactory return on and the means of amortizing a substantial capital outlay.

Any resettlement program of this sort is necessarily a matter of careful dealing with individual cases rather than one of spectacular wholesale evacuation. The merits of each case must be carefully reviewed. What are the present public costs entailed by the existing settlement? What are the prospective savings? What will it cost to relocate? These represent only one aspect of the question. The human factor also needs to be considered. An elderly, childless couple or an old bachelor represents a different problem from that of a young couple with a growing family. In one case, time may soon provide a remedy; in the other the problem is likely to grow rather than diminish, and it may be perpetuated indefinitely. How able is the settler? Is he a submarginal case which will require continued public assistance? If so, the question is primarily one of providing relief most economically and effectively. Savings in these costs may justify relocation. If the man is a capable producer, relocation may increase materially his contribution to society, giving an additional justification for relocation.

Relocation is inadvisable unless means are at hand for avoiding a repetition. There is no sense in relocating a man today if another will move into the same region tomorrow. For that reason, relocation is advisable only if there is sufficient control over land use in the area to prevent repetition. If the land is in public ownership or is under public control, this may be avoided. Zoning provides such control and therefore works hand in hand with settler relocation.

The appraisal of the settler's holding presents some knotty problems. If he is on submarginal land, does it have any value which will justify paying public funds for it? Granted that it has value for forestry or other uses, is this value sufficient to induce the man to accept the offer? Perhaps when he pays his debts and taxes, there will be nothing left. This is a problem which must be faced in a practical way. The primary reason for the purchase is to relocate the settler, not to acquire the land. This should guide the appraisal. The settler attaches a value to his place which may not be supported by its earning possibilities. At the same time, he will need some capital to become established elsewhere. There is logic in providing this through buying his land rather than in the form of an outright grant.

There are valid objections to so-called "bargain" settlement of delinquent taxes. However, there is merit in permitting adjustments where necessary in order to clear title to permit government

acquisition for relocation purposes. Taxing units should appreciate that it is to their interest to receive some of the overdue taxes rather than none at all, and also that they will share in the reduction in costs. Private creditors may be appealed to in order to obtain a scale-down of debt where needed to effect settlement.

There are differences of opinion with respect to how elaborate the facilities provided for the relocated settlers should be. Some emphasize the importance of good housing and favor setting people up in ready-made locations, fully equipped. Others maintain that the aid should be merely sufficient to give him the opportunity to work out the problem for himself. Certainly, if the man is expected to pay for it himself, the latter will have most general appeal. The danger of the former is that the settler will be so overburdened with debt that he will be in an impossible situation. Moreover, too heavy investment of public funds per case will limit the number that can be assisted.

The savings in public costs resulting from settler relocation do not necessarily accrue to the unit of government which undertakes this activity. The federal government has provided funds for this purpose. The savings, however, accrue mainly to local units of government and, to some extent, to the state. Justification for the use of federal funds, however, is found in the fact that the federal government represents all of the people and its revenue is derived from the entire population.

States participate more directly in the cost of such public services as education and roads than does the federal government, particularly through aids or grants of various kinds. Under some circumstances, local incentive to support settler relocation may be dulled by the fact that costs fall heavily on state aids. Under some circumstances, the result may be to lessen the amount of such aids which will be obtained. This suggests the importance of providing sufficient flexibility in the administration of aids to local units so that desirable land use may be aided rather than discouraged.

While the federal government has set aside funds for purchases of isolated holdings, the amounts available cannot reach any considerable proportion of the cases needing attention. However, states and counties are not without power to participate. Exchanging state or county land in developed or more suitable areas for the holdings of isolated settlers may come to play a part of increasing importance as time passes. It represents a concrete way of giving effect to districting under rural zoning ordinances.

The preceding discussion has drawn its illustrations from cutover areas. Settler relocation is called for in parts of the Great Plains as well, in regions where farmers are attempting to make a living from crop agriculture on land which is better suited for grazing. There is one difference between such areas and cutover lands. In the latter case, the objective is to get complete evacuation of given

areas in order to eliminate the need for providing them with certain services and to reduce fire hazards. In an area that is to be changed from crop farming to grazing, there will be a reduction of the number of people on the land as units are enlarged, but some families will remain and the need for public srvices will continue.

Settler relocation programs have not progressed far enough to warrant generalization with respect to actual dollars and cents savings. Conditions vary so greatly in different situations that at this stage of development it is better to determine the advisability of proceeding in any given situation on the basis of the facts revealed by an examination of that situation rather than to rely too much on results secured elsewhere. However, there is ample evidence that results warrant combined efforts to effect reductions in public costs and to bring about opportunities for the people involved to improve upon their ability to satisfy their wants and to become more productive members of society.

EIGHTEENTH SESSION

WEDNESDAY, OCTOBER 15, 7:00 P. M.

(Banquet Session)

St. Paul Auditorium

Senator Charles N. Orr, presiding.

TOASTMASTER ORR: Ladies and Gentleman: Upon the principle and in the spirit that "Whoso humbleth himself shall be exalted," the President of the National Tax Association has asked me to preside at this particular session. It is a great honor at any time, and in these days especially, to preside over any meeting where the first privilege offered is the privilege to rise and stand when any voice or band strikes up the strains of that martial and immortal lyric to which we delight to bend our heads and hearts in beautiful allegiance, to the splendid anthem, "My Country, 'Tis of Thee."

We have heard tonight the siren strains of that immortal lyric, "My Old Kentucky Home," which thrills wherever it pulses upon listening air. We have heard too the strains of that other immortal anthem in which, upon the plains of Minnesota, we catch the pulse and glory of your southern Dixie; and so tonight, I believe with the man who said, "Let me write the songs of a nation, and I care not who makes its laws."

The program tonight naturally divides itself into two parts—the speaking program and the skating show. You must endure the first in order to enjoy the second. We are running somewhat on a time schedule, and in view of the fact that I do not want any abridgment of my own time, I am respectfully suggesting to the speakers that they eliminate all preliminary hemming and hawing; that they eschew the thought that it is necessary for them to explain why they are upon this program, because Profesor Blakey with his usual perspicacity has taken care of that.

My purpose is to have them travel fast and finish strong, remembering always the admonition of Josh Billings: "It is better not to know so much than know so much that ain't true."

It is a great privilege for St. Paul to be host to such an intelligent group.

"He fills his lifetime with deeds—
Not with unfruitful years."

So wrote the Roman Ovid twenty centuries ago. Many people think this quotation fits the membership of this Association like a

pair of tights. But there are a few recalcitrants. There are a few who would modify that. We realize that this organization is composed of economists and tax experts. The public thinks they are a good deal the same, but they are not. An economist—and there are many of them—is usually a man who knows a great deal about a very little, and he goes on knowing more and more about less and less, until finally he knows practically everything about nothing. But that is not true about a tax expert. He is a dog of a different color. He is a man who knows a very little about a great deal, and he keeps on knowing less and less about more and more, until finally he knows practically nothing about everything.

I want to make myself perfectly clear, if I can, and possibly I may give you one estimate of a tax expert in the little incident which I am about to relate.

Cy Skimmerhorn had come in from the sagebrush of New Mexico and enlisted in the army. Cy Skimmerhorn was as noble a soul as ever lived, and he had but one ambition, and that was to make himself as good a soldier as the exigencies of the occasion would permit.

Unfortunately, there had been nothing in his past, in the way of education or training that contributed anything to Cy's being a good soldier. He had been living in a one-room house with the chickens and the pigs. He never had to do anything when he didn't want to do it.

But, anyway, he came in and enlisted, and the one qualification he had was his fine physique. After his enlistment he was referred to the doctors, and they looked him over from head to foot. You economists are doubless familiar with Bradstreet's ratings. He came out with the rating AA in every respect, and he turned away in the belief that it was finished. One of the doctors started to ask him a question. He said, "Cy, how about your bowels?" Cy promptly said, "They haven't been issued to us yet."

"No, no," the doctor said. "I mean, are you constipated?"

And he said, "No, I am enlisted."

That seemed to irritate the doctor a little bit and he said, "Good God, soldier, don't you know the King's English?"

And Cy said, "No! Is he?"

There are those present unkind enough to think that the army deprived the nation of a great tax expert.

I am sure St. Paul is glad that you are here. You give us the occasion for our greatest rejoicing when you bring to this occasion gastronomic the charming and accomplished ladies who bear your names and who represent the finest culture of our common country. In the myriad homes on earth, through all the progress of the centuries, it has been the woman who, in sickness and in health, in prosperity and in adversity, in sunshine and in storm, by loving ministry has sustained, comforted and made strong her man to fight

life's battles. And so tonight, ladies, whether you come from the broad reaches beyond the Rockies, or from the sunlit valleys of the Southland, or from that great section of our common country first kissed by the sunbeams as morning smiles upon the continent, we in Minnesota appreciate the compliment of your presence.

There is sorrow, possibly, in the hearts of some that I am not the principal speaker of the evening. In speaking about the principal speaker, it calls to mind a situation in a city in North Carolina, that great state from which the President of the National Tax Association comes. For many years they had been holding a cotton festival that had drawn a large attendance, but they had come to the conclusion that it was run down at the heel a bit and they ought to pep it up. So they wanted to get a national speaker. It was in a time when William Jennings Bryan was at the very zenith of his career. So they wrote him and he wrote back that he was traveling upon a very narrow schedule, but he would be glad to give them fifteen minutes, and the charge would be $500. Well, they thought the price was high and the time was short, but thought they had better go through with it. So at the appointed time Mr. Bryan appeared upon the platform. They selected a toastmaster, who used up eight minutes in introducing him. Mr. Bryan contributed seven minutes, bowed himself out, went to the depot and took his train.

One of the cotton men speaking to another, said, "Cy, how did you like the principal speaker?"

"Oh," he said, "I thought he was pretty good. But, by the way, that second fellow didn't do so bad either."

You may have suspected that I have been following the philosophy of Mohammed and his followers, who allowed each kneeling heretic an option between the Koran and the sword.

It is a very difficult matter sometimes to get these big guns before an audience in the proper manner. I spoke to the Governor and asked him if he had any skeleton in his closet that I didn't know about, and he promptly said, "If you get fresh with me tonight, I will take away all your patronage," and, frankly, gentlemen, I don't want to lose that janitor.

I spoke also to the distinguished head of the Tax Association, and he said, "Did you ever hear the story of the little girl down my way who wrote a story with a moral in it?" and of course I said I didn't know because I knew that he knew, and he was going to tell me.

He said it was late in October and the school children were very restless; the weather was warm, and the teacher, in order to concentrate their attention, asked each one to write a story with a moral to it, and bring it up to her, and as fast as they were brought up she would correct them.

This little girl wrote this story, according to the President. She said, "A little bird lit upon my windowsill. He was very hungry.

I made for him some porridge. He ate all the porridge, and then flew up in a tree and fell down dead."

Well, the pupils said they couldn't see the moral, and the teacher said she couldn't see the moral. But the little girl insisted that the moral was there. The teacher asked her to explain it, and she said, "The moral is simply this: Don't fly too high when you are full of mush."

Having, I hope, properly prepared the atmosphere, I am now willing to let you hearken to the learned program speakers, in the hope that you are prepared for "a feast of reason and flow of soul." I am about to present to you the President of the National Tax Association. It has been my privilege over many years to know most all of the past presidents of the National Tax Association. They number in their membership the most splendid thought upon tax matters that is to be found upon this continent. Last year the Association elected as president a distinguished tar-heel from North Carolina, who meets all of the specifications that I have heretofore referred to. I didn't know so much about him, but I put the FBI on his trail—and, well, I really discovered so much material that I had to discard it all. Suffice it to say that he is probably the man longest in continuous public service in the State of North Carolina. Long before 1907, when he was elected Commissioner of Corporations, he had held public office. He had been mayor in his own city. In 1929 he was elected Commissioner of Revenue, and wrote the sales tax of his own state. He is one of the distinguished tax authorities of this country.

I have great pleasure in presenting to you this distinguished citizen from that great State of North Carolina, the Honorable Allen J. Maxwell, of Raleigh.

President Maxwell: Mr. Toastmaster, Governor Stassen, Friends, Ladies and Gentlemen: I am very grateful to Senator Orr for this delightful presentation to this wonderful audience in this incomparable city. Before I finish these brief remarks I shall have something either complimentary or uncomplimentary to say of Senator Orr, but right at the moment I am wondering whether the National Tax Association should ever undertake to hold another annual conference or not. Certainly, this occasion is a mountain-peak in the experiences of the National Tax Association.

I feel somewhat like Peter when he wanted to build a temple on the mountain top. I am wondering whether we are good enough politicians down our way to ever get enough WPA money to build an auditorium that would compete with this. Incidentally, this great state and city have brought to this conference delegates and representatives from forty-two states and three of the provinces of the Dominion of Canada, a total registration of 659, and I think they are all with their friends here this evening. I don't know whether they

came to see this unusual setting, to hear a presidential address, or to hear an address from your nationally known Governor Stassen, or to see the ice show following. Personally, I would be afraid to submit that question to a Gallup poll. Incidentally, I would like very much to get Governor Stassen down to North Caroina and see if we couldn't make a good Southern Democrat out of him.

Now if I may turn for a minute to a more serious phase of this address—

THE NATIONAL TAX ASSOCIATION—A RECORD IN THE PAST THAT IS A CHALLENGE TO THE FUTURE

ALLEN J. MAXWELL
President, National Tax Association

For the last year I have gone along under a pleased puzzlement as to why this association, at its convention in New York last year, was generous enough to honor a then semi-invalid with its presidency. I have recenty found the answer. It was reaching out and searching for the ideal. In looking through its archives—the volumes of its annual proceedings—(free with each five dollar membership) I found that at its convention in Baltimore in '37 the then president, Judge Oscar Leser, quoted with apparent approval a former president, Henry F. Long, that " the ideal president of the National Tax Association is a person who neither says anything or does anything or knows anything."

In 1939 President Stone modified this slightly with the admonition that the president should not take himself too seriously, in the thought that if the president should violate the rules and accidentally say anything the Association was in no way responsible for it. In other words his expressions should stay within the narrow range of advice of a cotton merchant, when asked his opinion as to the price of cotton, replied " it may go up or it may go down, but understand that is my personal opinion and not the opinion of the firm."

Under these precedential presidential limitations it will not be expected that I settle the world conflict or pay the national debt.

However much we may dislike the idea, there are some elements of distinction in the mere fact of age. It indicates a healthy beginning and the use of sound judgment in meeting the dangers that lurk along the way.

Thirty-four years is not very long on the calendar of time, but the life of this Association has covered a period of growth and progress, in wealth and power and in public service, in this country, never equaled by any people in any country in any age.

May we not indulge the satisfaction of believing that this Association has made an important contribution to this result? I think

we may. I know that it has. Unless this were true it would not itself have continually grown in influence and in the reach of its ever-increasing voluntary membership.

The need for it was so great that it immediately attracted a national recognition that brought to its annual forum the best talent in the country—in public service, in colleges and universities and in business—to bring their best thought in research, analysis and experience. It has not been an axe-grinder for any interest. The beneficial results of these discussions through the years can be found in tax structures of federal and state governments and in administrative practices.

The all-inclusive federal, state and local tax burden in the United States has multiplied nearly nine times in these thirty-four years (from $1,651,843,927 in 1902 to $13,794,718,327 in 1939—years most nearly coinciding with the life of the Association for which I find figures available), and this does not include the extraordinary defense taxes since 1939. The federal tax bill alone, in this fiscal year, will equal the over-all figure for 1939. Estimates now are that the over-all tax burden of 1942 will approach $25,000,000,000. So the Association's job, without counting defense taxes, is about nine times as big as it was to begin with. And yet, with that smaller tax burden it came into existence at a time when tax administration, operating in a narrow range and with inadequate administrative methods, was creaking at every joint in its efforts to carry the then expanding load demanded by growth and progress.

The most frequent expression found in its earlier conferences was that "the general property tax has broken down." It was breaking down partly because we had placed the whole load of state and local government on one wagon, and partly because we had not provided adequate machinery for administering it, as it developed ever-increasing complexities with the development of nation-wide business.

No one can measure the influence of this Association in its contributions to a solution of both of these great problems—broadening the base and improving administrative machinery—nor to the contributions which even a partial solution of these two problems has made to the progress of our states and country.

I presume opinion is unanimous that the Association has been most useful in the educational field. The influence of its annual conferences in this field have been beyond computation. But while it has achieved a high standard of excellence and authority in addresses by masters in all phases of taxation and related economics in all its annual conferences, it has been much more than a debating society. It has indeed been a good politician and that is an important reason why it approaches its thirty-fifth year in full strength and vigor. The ideal issue for the ideal politician is one on which there will be unanimous agreement—such as original sin or the final

perseverance of the saints. The Association has not been quite as good as that. It recognizes that absolute unanimity is very rare. It aims at substantial unanimity and agrees that this is achieved if more than four-fifths approve. Its achievement has been that in its high aims, and by its ignoring of the highly controversial and the politically partisan, and by the competence and skill of those who have sought to lead its thinking, it has been able to develop this substantial unanimity of thinking and support on questions of great importance. Its constant aim should be to continue this process. Time and again it has spoken opinions that carried weight because they had behind them this substantial unanimity of opinion of competent people laboring in the public interest.

I mention two outstanding achievements in this field of positive action:

The first specific action that I have in mind is one that will immediately suggest to this conference one of the finest characters who ever labored through these years to make the National Tax Association what it is—Dr. Charles J. Bullock, who passed to his reward during the present year. I am sure the resolutions committee will not everlook a proper tribute to his life and labors with us. In the depth of his knowledge and the breadth of his thinking he was tops. He was not content with his mastery of the text books and the fundamental equities and economics involved, but frequently used vacation periods nosing through court houses, city halls and state departments, investigating the technique of administrative practices in the hinterlands. He was not content to discover weakness and error, but fought unceasingly to correct them.

His recognition of the need for and development of support for the model plan of state and local taxation, and his prodigious labors in putting it into proposed statutory form, will probably remain for many years as the outstanding contribution to this Association, and to the cause of progress and uniformity in state tax legislation. Thought and exact language from this report can be found in the statute laws of many states.

The Association sponsored and put over the eighty percent credit of the federal estates tax in the 1926 act. This has been far-reaching in its wholesome effects. It not only protected state revenue, and stabilized state inheritance tax rates, but it shut the door in the face of tax avoidance. It closed the loop-holes provided by a few states that sought to lure wealth away from other states with tax exemption. We have a better stabilized tax structure in all the states by reason of this action. Some day some inquisitive mind, searching through the record of its procedings, is going to ask why the Association, after its brilliant success in this outstanding achievement, tired of its labors while there were other equally important fields of ununiformity and inequality to conquer.

If these remarks find a place in the proceedings of this conference they will bear this title: "The National Tax Association—A Record in the Past that is a Challenge to the Future." If I have any thought that is worthy of presentation to this distinguished group it is the one suggested in that title. Is it not possible for us to concentrate and organize our thinking upon some other worthwhile project in this almost unlimited field for usefulness and high public service? Can we not make some other definite contribution, as an objective of the Association, to smooth out inequalities, insert a few ball bearings, or at least apply a little axle grease to make the load pull easier? Isn't it about time for the Association to have another baby? As an Association sponsored project, our youngest son is nearly old enough for the draft.

At our conference a year ago, a resolution was adopted providing for a special committee on Co-ordination of Federal, State and Local Taxation. We have a committee of able men who accepted service on this undertaking. It was my pleasure to appoint Commissioner Henry F. Long as chairman of this committee, both because of his eminent fitness for it and also because he is chairman of a committee of the American Bar Association making a study of the same subject. The National Association of Tax Administrators has since appointed a like committee.

It is my understanding that our committee will make only a preliminary report to this conference. It has mapped out a course of study that will carry through to the next conference.

Here is a problem that is a challenge to all the statesmanship in this Association. I apprehend that the greatest difficulty encountered will not be in finding something practical that can be done, but in finding so much that needs to be done that it will be discouraging to undertake it at all. However, I am not undertaking to anticipate the final report of the committee, but merely to put in a plug for the gigantic task it has undertaken, and to express the hope that its report to the next conference will give our Association a task worthy of its best traditions. Incidentally, our immediate experience emphasizes the need for a better coordination of federal and state tax laws. There is complaint in many states that the recent federal revenue act will have the effect of reducing their state revenue, while other states are experiencing a large increase in revenue incident to the tremendous increase in federal spending.

There has been much wholesome discussion in our conferences in condemnation of state laws that set up trade barriers that discriminate against interstate commerce. I rejoice in every court decision that strikes down any discrimination against interstate commerce. It is of major importance that no discriminative barriers be set up at state lines. But let us not be confused in our thinking on this subject. It is just as important that there be no

discrimination for, as that there be no discrimination against, interstate commerce. One of the most wholesome trends in court decisions is that the court of last resort has finally and completely reversed its long line of decisions on this question and now holds that "interstate commerce must pay its way." Neither local nor interstate commerce should be barred by discrimination. This result can be attained only by equal taxation. Much of the recent discussion of this subject is aimed at striking down this equality, and restoring a preferential status to interstate commerce.

I promised not to undertake to settle the world conflict, but will venture a word on it. It is frequently suggested that we should not this time win the war and lose the peace. We are going to win the war. The question of primary importance now is a united country in support of nationally declared policies in one of the gravest moments of world history. I refer to this subject mainly to record a thought as to one method by which we may endanger the peace. Indices now are pointing in the direction of a national income this year close to a hundred billion dollars, or two and a half times as great as nine years ago. In large part that is a reflection of spending unprecedented sums for preparedness. In many jurisdictions this will result in revenue yields far in excess of dependable normal yields. To adjust our budgets to this undependable and temporary inflation of revenue may lead to disaster in the aftermath of the war. It is of course fundamental that taxes should be levied only to meet legitimate expenditures for public purposes. But in this extraordinary and temporary situation it seems to me that surplus revenue resulting from it should in the main be used to pay outstanding public debts, or set aside as a reserve fund for the inevitable emergency that will follow. It will be sorely needed then to cushion the slump in revenue, and as a basis for cooperation in a public improvement program to take up the slack in employment, and to provide needed facilities that cannot now be provided in competition with the national program. Our steady course for the future should be charted in the calm seas of peace times.

There is only one other thought that I wish to present, my friends. There have been many compliments on the scope and character of the program at this conference and the fine character of the addresses that have been made. The gentleman who is mainly responsible for that successful part of this program has remained in the background and has been seen only in the shadows. He is a very able member of the staff of the University of Minnesota. Down in North Carolina we learned quite some years ago of the high qualities and character of this gentleman, and succeeded in getting the benefit of his services in making a tax survey in our state. He is a steam engine without a whistle. I refer, Your Excellency, to Mr. Roy G. Blakey, of the Economics Department of your state university.

He has rendered an outstanding service to this Association, he and his committee, in preparing the wonderful program that we have had. I don't know how much you pay him, but I know you don't pay him as much as he is worth, and I am going to take the liberty of making a suggestion about that, and I am going to be modest about it. You ought to pay him half as much as you pay the head coach of your football team, and at least as much as you pay the first string fullback on your team.

There is one other suggestion I want to make, and then I am through, and that is a recognition of the wonderful service of Senator Orr as chairman of the Entertainment Committee for this conference. He has taken care in a wonderful way of the gentlemen attending this conference and has seen that every idle moment that he could find was well filled, and the charming Mrs. McConneloug and her charming associates on the Ladies Committee have provided marvelous entertainment for the ladies attending this conference.

I am sure that I speak not only my own very genuine thought but that of everyone attending this conference when I say that they are deeply indebted to Professor Blakey and his committee, and to Senator Orr and his committee, for making such a wonderful success of this conference.

I thank you.

Toastmaster Orr: Thank you, Mr. President, for this feast of reason and flow of soul. I call your attention to the kind words that you said of me, and ask you to remember the biblical injunction that, " He who flattereth with his lips layeth a net for his own feet."

Ladies and gentlemen, many years ago a distinguished New York physician was traveling for his health in the foothills of the Ozark mountains. He was using as a method of conveyance a buckboard and a team of horses. He came at eventide to the home of a farmer and asked for refreshment and lodging for the night. The farmer said, " It is impossible for me to take you in because my wife is sick with pneumonia, and the only physician in this part of this country is at his home suffering from diphtheria."

The great physician said, " It is fortunate that I have come to you at this time, for I have had great experience in the treatment of that particular malady."

So the farmer took him in, and he ministered not one night but through many days to the good housewife, and during the odd intervals he debated with the farmer, who had very pronounced views upon public questions and upon men in public life. At the end of twenty days the good housewife had been nursed back from a condition near unto death, to health and happiness. The great physician called for his team, that he might proceed on his way.

The farmer said to him, "You came to me in no professional capacity, and therefore I owe you nothing."

To that the physician made no objection. The farmer said, "Furthermore, I have a lien upon your team for their keep and your keep while you were here."

To that the physician objected strenuously, and they debated the question briefly, when the farmer suggested that they leave the matter to the local governor, who was sojourning at the old homestead some five miles away. Together they proceded to the governor's home and submitted it much as I have submitted it here to you.

The governor, after listening to it, made this ruling: that if the farmer would convey the great physician to the railroad station where he might proceed upon his way, every legal and moral question would have been settled, and that he might retain the team until the lien was satisfied.

Together they left the governor's house, and before they entered the conveyance the farmer turned to the physician and said, "My wife and I haven't done very well in this world. We own our little home, which is clear. By great frugality we have saved up some $500, which my wife has hidden away in a mattress. I am going to take you home. I am going to have my wife cook you the finest meal that you have ever tasted. I am going to curry off your horses. I am going to fix them up, and after you have partaken of that meal we are going to put you in your buckboard and I am going to place that $500 in your possession. The only reason why I did the things that I have today is because in no other way could I ever have convinced you as to what a dumb governor we have in our state." (Laughter)

Ladies and Gentlemen, that was many years ago, and in a foreign jurisdiction. I am about to present to this presence the distinguished Governor of Minnesota. For more than three decades it has been my privilege to work very closely with governors. I have known them even in advance of that period. I have no hesitancy in suggesting to you that I know of no time in that period or before when any governor has given us a more economical, a more honest administration than the present Governor of Minnesota. A young man, yet in the very morning of his career, we find him known favorably and well throughout the nation. I know you will be delighted to hear him, and if his eloquent lips have not forgotten their cunning, and his skilful tongue how to reach your inmost hearts, I am sure tonight that he will deal in a forthright manner with some of the subjects that have been considered at this conference.

I have great pleasure, ladies and gentlemen, in introducing to you the Honorable Harold E. Stassen, Governor of Minnesota.

His Excellency, Harold E. Stassen: Thank you, Senator Orr, President Maxwell, Members and Guests of the National Tax Association:

It has been an honor for our North Star State to have had meeting in our midst this distinguished gathering, facing problems of extreme importance to this country of ours today. I trust that our committees have fulfilled their charge to make you feel at home, to make you feel that sweeping down from our ten thousand lakes has been a breath of welcome, making you wish to return to this vacation land of ours.

May I further, at this time, express the official appreciation of the people of the state to the distinguished chairman of your general arrangements committee, my friend and able public servant of Minnesota, Senator Charles Orr, and his colleague, Professor Blakey, and his associates for the manner in which they have discharged their responsibility to you during your conference.

I would not trespass long upon your time on such a delightful evening as you contemplate in the entertainment to follow, but, having been requested to address you upon the subject, "Defense and Taxes," I would speak briefly and frankly upon some of the basic questions of tax policy confronting us here in America in these days, cognizant, as we are, of the tremendous impact of world affairs and the sternness of our defense program. May I say as I proceed with candor to discuss some of these questions of basic policy that I do so upon this background. I have already taken the position, which I reiterate, that in hours such as these there should be no partisanship in this land of ours, no division in the united support of the President of these United States in his foreign policy. For, as I have often emphasized, America cannot have two foreign policies, and the administration placed in power by the democratic process of this nation has the responsibility of carrying out that foreign policy, and we have from the very early days stood steadfast in support of the decisions of the President and the national government in these matters. Upon that background then, we are justified in turning our attention to a sincere, candid discussion of basic policies on these matters that are of such tremendous importance to us, not only in these hours of emergency, but in the decades that lie ahead for our great nation.

The statement that the power to tax is the power to destroy has been oft repeated, but, bringing it up to face us tonight, it can well be said that we should not forget and neither should those in any position of authority forget that even in times of emergency the power to tax can be the power to destroy a free economy and individual initiative.

The power to tax can be the power to install a master planned economy bearing many similarities to the Fascist controlled econ-

omy and the Nazi controlled economy. Thus it is, recognizing, as I know you all do, the tremendous effect that the power to tax can have if its administration and its basic philosophy are not sound in times of emergency, that when we discuss tax policy tonight we consider a matter of extremely vital concern to the future of our beloved land. It seems to me that the basic principle of our tax policy should be that the power of taxation is used primarily to raise necessary revenues to conduct government. The basic underlying principle of a tax program should not be viewed as primarily one to redistribute purchasing power or to develop a planned economy. The basic error of this approach, to use the mechanism of taxation to redistribute purchasing power, lies in the fact that this approach concentrates upon the question of the distribution of that wealth that has already been produced without due regard and proper recognition of the effect of the policy upon the future production which is much more vital than the previous question. We can well give an example of this matter. Of course we can take an isolated situation and say: "Here is an area that has an accumulation of wealth and here is an area that is deficient; it is easy to take and skim off some here and put it over there." Looking at it only from the standpoint of today, it may seem somewhat equitable but yet the great danger is in what will be the effect of that procedure upon the future production, upon the future initiative of both of those who have it skimmed from them and those to whom it is given.

This matter of approaching from the standpoint of general plan and a revising and reorganization of purchasing power reminds me of that story that is told of the great irrigation project in a valley in the West conducted by a great series of wells and a great series of pumps. From each of these hundreds of individual wells and pumps the water of life for vegetation flowed forth to cause fertile crops to grow, but there were some difficulties, some of the pumps didn't work quite right, some of the crops didn't mature in certain fields. Along came a man who said he was an expert in irrigation and he could work out a master plan to care for this irrigation problem. As the first step of the master plan he proposed he would disconnect the separate wells and separate pumps from their fields and began to connect them together into a great master reservoir and master plan from which the entire valley would be irrigated, but the tragedy was that during the period while he made all the disconnections and while he began to put them together into a master plan the fields dried up for lack of moisture, and instead of having fields here and there that were properly served by individual pumps they found that before a master plan and a master pump could be made to operate the entire valley became just another valley in the West. That story, it seems to me, emphasizes the extreme care

with which we must seek to rearrange an economic system that has grown up on a basis of individual initiative and free enterprise.

It has been said that the present shortages that we recognize in this country show that the system of government forcefully entering into the spending of great sums of money proves that this is the right way to meet the maladjustments that have existed in our economic system. I do not agree with that conclusion. It seems to me that the shortages that we have encountered so quickly in our defense program in many basic materials, the shortages we have come across so quickly in skilled mechanics and in skilled workmen, the shortages that we have found in many fields of transportation, the slowness with which we have stepped forward in airplane production, far from showing that now we have proved the correctness of a government procedure of heavy spending, that on the contrary, it shows that a program of that kind over a period of years has developed weaknesses, has kept our economic system from going forward, so that we did not have the resources to draw on quickly in hours of emergency such as we are now facing.

If it would become a settled and known governmental policy that he who saved would have it taken from him, that he who produced would be regimented and have the fruits of his production taken away, and that he who neither saved nor produced would have handed to him ample purchasing power, it would be a major tragedy in the history of this land.

Government in meeting problems of maladjustments can and should fully meet the needs of the people. No one in this land should ever suffer for lack of food, shelter or clothing, and the tax program to secure the revenue for that purpose should be carried out. But that program of meeting needs should not be carried on on the basis that we are in some way correcting an economic system by doing it or in some way creating a purchasing power that is a solution. It is only a temporary answer to a maladjustment that exists.

Government in a free economy, a democratic government, can and should provide a cushion against the harsh effects of our economic system, but government cannot successfully furnish a bed upon which society can go to sleep. The problems before the country today should be frankly and directly faced, instead of placing our reliance in the hope that a certain tax program indirectly may provide the solution needed. We all know that we face a very critical danger of inflation in America today, that once that wild horse begins to gallop it leaves a terrible destruction in its wake. The danger of inflation should be faced today in America four square.

These are some of the steps, direct steps, that I feel should be taken to meet it, rather than relying on indirect steps of using the mechanism of taxation to meet the problem. The first direct step, realizing what purchasing does in a step toward inflation, should

be the reduction of 20 percent in non-defense federal expenditures and concurrently the reduction of 20 percent in non-defense state and local expenditures. These are times for sacrifice and it is not for us in the states or local governments to say "The Federal Government should cut down its non-defense spending," nor for the Federal officials alone to say that the states and localities should cut down, but together we should face the mutual problem and in a nationwide program eliminate at the same time $1 out of $5 spent nationally and $1 out of $5 by local governments for items that are not essential to the defense of freedom.

Secondly, we should have promptly a nationwide agreement negotiated with the leaders of organized labor placing a ceiling on wages in this country to prevent inflation.

Thirdly, there should be a nationwide agreement with the leaders of agriculture, supported by public opinion from frank presentations, on a fair ratio of agricultural prices to other prices and the fixing of a ceiling in that regard.

Fourthly, the government should fix the other prices that are not established in that manner with definite price ceilings.

Then in reference to the policy of limitation on production, whereas we know we must limit the production of automobiles, refrigerators and those items, the limitations, instead of being placed on a basis of so many cars or so many refrigerators, should be placed on a basis of allocating a certain amount of the vital raw materials in order to give free enterprise, the manufacturers, the chance to make progress in developing new substitutes not needed in defense, new ways of using those materials to produce a greater quantity to use up some of the purchasing power and without using any greater quantity of defense materials. In other words, it seems to me that when you say you shall produce so many thousand automobiles you are approaching it exactly from a standpoint of a rigid planned economy, but when you say that "In the emergency we are confronted with, you can have so many thousand tons of steel, you do with it what you can," then you are giving free enterprise the greatest possible opportunity to continue to function in the way in which it has while this country has been made great.

We should face problems of that kind frankly and at the same time make a nationwide appeal for savings by individuals, convincing the rank and file citizens of America that if they in this hour when dollar wages are high and their dollar incomes are high put aside as great a proportion as possible for the years and problems ahead, that if they do that they will be better off in the years ahead than those who do not do it. If we can have nationwide appeal upon that, that in turn will fit into these other problems. But in facing these problems and taking forthright steps to meet them we can work out the solutions needed and meet the emergency and

danger before us without submerging ourselves in a rigid planned master economy. And I realize, as it has been said, that the very basis of our government, federal in nature, with forty-eight independent states, with many local units of government, tends to prevent a planned economy, tends to prevent a federal government alone seeking to work out the master plan on that basis, but, far from saying that for that reason we should centralize all of the powers that the states now have on many fields of taxation in the federal government, I believe the very fact that those state structures prevent a master planned economy is good reason for preserving them and safeguarding them. In other words, looking ahead to the liberty of our people in the years ahead, if we can maintain a strong federal system where all of these states in turn strengthen the total structure but each is a bulwark of liberty, that in itself is a sound reason for their preservation. But let us not rest as states and local governments alone upon that principle. Let us realize that the very urgency of the situation not only presents to us the need of conserving at home but the challenge to make state and local governments more effective and more efficient in the handling of their problems.

We have gone forward in steps of that kind here in Minnesota with the very able cooperation of Senator Orr and his colleagues in the Senate and in the House and took steps three years ago to streamline our state government, to fix definite responsibility in department heads, to establish a central business manager, to reduce debt and build up reserve, trying to make government more efficient and effective so that the people would have confidence in the state type of government as a part of the total American system.

We must face these challenges. Seek ever to build up the confidence of the people justly in the efficiency of the manner in which we conduct all levels of government and on that basis encourage also the future industrial development of the results of our research and invention and discoveries, pushing forward, realizing that in these great developments through the result of American genius rests the future, not only of people here, but elsewhere.

We can make progress. To state it clearly and succinctly, as a basic part of our philosophy in approaching a tax policy, I say I would rather trust the individual initiative and enterprise of 130 million American individuals than the greatest master plan that could be worked out by all the intellectuals who could be gathered in one place at one time.

I have spoken frankly upon these matters because these are days to face problems frankly. I know there are those who say, as we hear the tragic news from abroad, that these are dark days in the world, that these are dark and uncertain days as to what the future steps of this country shall be. But may I say, let's never forget that there have been dark days in the history of the world before

and there have been very dark days in the history of this beloved country of ours before. Let's have a fundamental faith and courage and determination and believe in the future of free men and free women under the Stars and Stripes.

TOASTMASTER ORR: Thank you, Governor Stassen, for these words of wisdom.

May I suggest to those present that the ice show will go on immediately. Pardon me if I steal just a moment to express my appreciation to the members of the committee that have worked with me in your entertainment. I recognize that I have received the encomiums and so forth, but they are actually meant for each of the men and women who have responded so nobly in this effort, and I express to them my deep personal appreciation.

The ice show will be directed by Mr. Julius Perlt. Mr. Perlt will now take over.

(There then followed an elaborate ice show.—EDITOR.)

NINETEENTH SESSION

THURSDAY, OCTOBER 16, 9:10 A. M.

Ballroom, Lowry Hotel

JOHN C. CURRY, presiding.

CHAIRMAN CURRY: Ladies and gentlemen, we will call the meeting to order. I know that the entertainment of last evening has kept a good many in bed this morning, but Mr. Long has a report to make, and we will start right ahead.

We have heard, of course, a great many discussions during the last several days with reference to the position of the states and the position of the federal government in the tax scheme, and no doubt a great many wonder what is to be done about getting each in its proper place.

We have a preliminary report this morning from the committee of this Association on Coordination of Federal, State, and Local Taxation. The chairman of the committee needs no introduction to this audience, but I would like to say that in addition to being chairman of this committee he is also chairman of a similar committee of the American Bar Association and chairman of a similar committee of the National Association of Tax Administrators, which places him in an unusual position to bring about coordination, if such a thing can be done.

We will now hear the preliminary report by the Honorable Henry F. Long, Commissioner of Corporations and Taxation of Massachusetts.

HENRY F. LONG: Thank you very much, Mr. Curry.

There is a very definite temptation that I have to tell a story so as to get it into the record, but I am not quite sure how I would hook the point of the story to anything that I may now be going to say. So possibly I can use it at the tail end of the report, rather than at the beginning.

It seems to me before making this report it would be permissible to repeat in a way what the presiding officer has indicated. The idea of the coordination of federal, state, and local government tax structures is very general. You hear it from all manner of sources and in all kinds of places. In many instances all probably have experienced, as I have, the enunciation of the thought that there should be coordination, from persons who give you the impression that the idea was entirely new with them, and that they were going to suggest it so that it might be put into being. But it is rather

odd that during the last two years or more a great many groups—in fact, almost too numerous to mention—have started some form of investigation or activity or research leading toward the coordination of the federal, state, and local government tax structures.

I may be in error, but I am of the opinion that at least two outstanding agencies of the federal government and possibly more are themselves engaged in it, and the development of the thought of coordination has been taking place over quite a period. I think coordination in the minds of many of these groups that we are now witnessing as taking an active part in these attempts may have the origin of that urge in the desire, in the welter of tax obligation, to so protect their own tax-paying requirements as to not, in their own opinion, be unduly burdened. It is because of that that I rather suspect that various forms of organizations dealing with particular kinds of activities have committees now either actively or inactively engaged in this coordination.

Coordination also, it seems to me, has its origin in the pressure which comes on the part of many taxpayers to relieve themselves of what they feel is duplication of requirement in reporting. There may be some color to the suggestion that on the one hand they may want to minimize their taxes; but there is very much strength in the suggestion that they really want, as accurately as possible and as speedily as it is possible, to determine what their total obligation is to be, and that the same thing be not taxed twice.

I think there may be a third thing in the picture, and that is the tendency, particularly in the structures as they separate themselves in the three layers of government, to tax taxes. The federal government is guilty of taxing taxes, the state is guilty of taxing taxes, and similarly the local governments are taxing taxes, and probably one of the first things that could be done, and rather easily, without perhaps any great controversy, is to at least call to attention the duplication so far as reports are concerned, and the attempt to coordinate those particular activities; and second, to eliminate—or at least the suggestion can be made to eliminate—from the various tax laws these provisions which unwittingly tax a tax which has been paid to some other state.

The other suggestion that I have to make in respect to this is that the difficulty lies in the field of understanding that, after all, the layers of government, or the levels of government, are all supported by the same people, because each of us is a citizen of his own community and of the state and of the federal government at one and the same time, and each 24 hours there is some benefit or nominal protection or some aid given in one manner or another to us as individuals in protection of our lives and property and in support of the development we may wish to make, by the federal government, the state government, and the local governments; and there is, therefore, hooked up with this thought of coordination the possi-

bility that there will ultimately be, perhaps, stemming from the coordination of tax structures, a coordination of the activities of government for the benefit of the individual.

Some might argue that that may, of necessity, come first, and particularly so because the federal government now is engaged in national defense, and possibly can be very easily excused from being too nice about the manner in which revenue is to be obtained. When stress is in control, you can't look for many refinements, and in this process the ultimate solution of it may come from the states and their political subdivisions, which if the national defense requirements develop as they promise to, will be directed toward coordination of their own governmental affairs, and thus interlocking that ultimately in what the federal government may do when the national defense requirements no longer are pressing, and out of that allotment of the things which the governments will do, will come the sort of tax sources which should be employed to support those particular activities.

I think the common thought would be that those particular functions which affect the people more closely should be performed by the units that the people are more accustomed to; and yet that they break down to the larger thought that the larger unit, whether it is the state or the federal government, may be more capable of performing that particular function for the benefit of the local unit than is true of the unit itself.

Following closely on the heels of that would be the thought that because that was expressed locally, and the benefits derived locally, that then that form of revenue which was most closely connected with it should be delegated to the local units in performing their function. And finally, they would have the conflict between the thought that there would be either a separation of sources, a complete isolation of some revenue opportunities to the different units, or that there would be a division, and it is in that picture that we have our struggle.

The report, which is a report of progress, is as follows:

Your Committee on Coordination of Federal, State and Local Taxes created through the action of the 1940 Conference consists of

Henry F. Long, *Chairman*

Carl H. Chatters	Clarence Heer
Franklin S. Edmonds	Albert Lepawsky
Fred R. Fairchild	Mabel Newcomer
Charles W. Gerstenberg	Dixwell L. Pierce
Clifford Goes	Carl Shoup
Mark Graves	Colin F. Stam
Welles A. Gray	Thomas N. Tarleau

At the time this Committee was established by appointment of the President of the National Tax Association, there was in being a similar committee acting for the Taxation Section of the American Bar Association. It was deemed desirable to join the National Tax Association with the American Bar Association Committee, which was done. Subsequent to such consolidation in June of 1941, the National Association of Tax Administrators named a similar committee, and that too has been joined, so that there is now operating with the National Tax Association a similar committee of the American Bar Association and the National Association of Tax Administrators.

The American Bar Association Committee has progressed a bit in getting a general plan outlined for an approach to this subject and had spent some time in the development of a bibliography, which was adopted as a worthwhile action by the Committee of the National Tax Association, and that bibliography now is being moved forward rapidly so that there will be available to all a complete list of those things which relate to taxation. This bibliography it is hoped within the immediate future will be printed as a Congressional document and made available to all who may have an interest. The effort has been to include in the bibliography all matters which in any way relate to taxation, and exhaustive efforts have been made to discover every possible item of source material relating to taxation in so far as it relates in any way to the problem of the Committee on Coordination of Federal, State and Local Taxes. It is hoped that members of the National Tax Association who, after seeing the bibliography, find that material with which they are familiar is not included will advise so that the bibliography and the additions to it will be constantly increasing in its effectiveness.

The Committee, subsequent to its uniting with the Committee of the American Bar Association, felt that the problem was so extensive that the best approach to it would be through an established agenda. With this in mind an Agenda Committee was appointed consisting of Fred R. Fairchild, head of the Department of Government at Yale University, Charles W. Gerstenberg, Chairman of the Board, Prentice-Hall, Inc., and Franklin Spencer Edmonds of the Philadelphia Bar and a member of the Pennsylvania Senate. This Committee reported an agenda which, with some changes, was adopted, and which read as follows:

AGENDA

I. Classification and Enumeration of Problems

The Agenda Committee believes that there are certain questions of principle which the Joint Committee might consider in full meeting at once and other topics which should properly be assigned for

preliminary study by subcommittees. The scope of each of the topics assign to subcommittees will be more or less dependent upon the conclusions which the Joint Committee may reach as to the questions of general principle.

1. Questions of General Principle. The Agenda Committee proposes that the Joint Committee give consideration at once to the five questions stated below. Of these, the first three are regarded as in a way preliminary and likely to produce, without much debate, answers having the unanimous or nearly unanimous assent of the Joint Committee. The other questions may possibly bring out differences of opinion among the members of the Joint Committee and lead to extended discussion; their answers may indeed not be arrived at until the Joint Committee is well along on its investigations. Even so, it would seem advisable to make an early start upon their consideration.

(A) Should it be the object of the Joint Committee to recommend an ideal distribution of sources of revenue and of methods of collection for the three levels or grades of government, national, state, and local, with reasonable regard to the ultimate possibilities of partial or complete realization, or should the committee aim to suggest a plan that may be advanced for immediate substantially complete adoption?

(B) Is the Joint Committee prepared to accept the existing constitutional allocation of sovereign powers to the federal and state governments respectively, and is it prepared to lay down the premise that the proposals it will make as to coordination of federal, state, and local taxation shall not tend to impair or weaken the financial integrity or sovereign powers of either the federal government or the states?

(C) Is the Joint Committee prepared to accept the principle that the primary purpose of taxation is to raise revenue, and that the use of taxation for regulation or other purpose is to be approved only in exceptional cases and when supported by strong argument in each particular case, and that those who urge such other uses of taxation must accept the burden of proof?

(D) Will the Joint Committee accept the principle that in general each grade of government should support its functions from its own revenues?

(E) Will the Joint Committee accept the principle that in general the government (of whatever grade) which raises the tax revenue should have control of its expenditure?

The Joint Committee may find it expedient to invite its members to formulate other similar canons and to discuss them, either directly or after they have been considered by subcommittees constituted for that purpose.

2. SPECIFIC TOPICS FOR ASSIGNMENT TO SUBCOMMITTEES

(A) What Distribution should be Made of the Functions of Government among the Three Grades of Government? This question leads to the following questions:

(a) Should government (any grade or grades, jointly or singly) add new functions and, if so, where? (b) Should certain functions now assumed be relinquished? (c) Should there be a redistribution of any of the functions of government now assumed?

Possibly the Joint Committee in deciding whether such a subcommittee should be constituted will care to discuss some questions of policy respecting the distribution of governmental functions, and in the light of its conclusions, if any can be arrived at as a result of such preliminary discussion, may decide to ask the subcommittee to give concrete and detailed recommendations as to the proper distribution of the classes of functions.

(B) Adequacy of Revenues. This problem should include a quantitative study of the cost of performing the functions of government as distributed by the Joint Committee after it has considered the reports of subcommittees and of the adequacy of present revenue. It would seem that this subcommittee could not begin to operate until the work of subcommittee (A) had been disposed of, and it is true that its work would not be finished until the Joint Committee is about ready to complete its final report. But it can begin immediately to discover the sources of information on which it must rely and may even be in a position to tell the Joint Committee at any time to what extent it may expect to justify proposed recommendations. Moreover, by assembling the sources of secondary information immediately, the Committee may learn if research into primary sources of information is necessary and expedient.

(C) Statement of Deficiencies of Present System. The formulation of an "indictment" against the present system would have at least three purposes: (a) It would show the reasons for the committee's undertaking; (b) It would furnish material for the final report of the committee and would for this purpose probably recite other "indictments", such as those contained in the talks of Mayor LaGuardia and Governor Lehman at the 1940 Conference of the National Tax Association; (c) It would provide a check list of "evils" with which the Committee could compare its proposed plan to assure itself that the present evils are remedied as far as possible.

(D) Means for Achieving Uniformity in Methods of Reporting Tax Bases for Assessments by Different Levels of Government. This is a task dealing with one phase of procedure which probably can be segregated from the other recommendations of the committee's report and therefore can be undertaken separately.

(E) The Income Tax. This is the first of seven topics dealing respectively with the principal types of taxation which raise questions of coordination. The following arrangements (among others possibly) should be investigated:

(a) The tax in question may be assigned to one grade exclusively. (E.g., customs.)

(b) Two grades may use the tax without restriction. (E.g., income tax as at present.)

(c) One grade may collect the tax and distribute it in whole or in part, (1) with control of expenditure, (2) without control of expenditure. (E.g., mortgage taxes in New York.)

(d) One grade administers and collects and the other adds its rates. (E.g., property taxes in many states, and French centimes additionnels, German Zuschlaege and Australian income tax.)

(e) Two levels may collect, one allowing credit for the tax paid to the other. (E.g., death duties as at present.)

The subcommittee should understand that its task is to explore possibilities. It may make definite suggestions as to fitness of respective methods, but its members should suspend judgment in coming to final conclusions till they have had the benefit of discussion by the Joint Committee. Following the report of this and other similar subcommittees the Joint Committee will be in position to consider such questions as:

1. Should each grade of government have its own source of revenue or certain sources of revenue free from invasion by the other grades?

2. Is it possible to work out one or more general methods of distribution among the grades of government of the proceeds of a tax collected by one grade?

3. Should there be any limit on the compounding of taxes (taxation of same subject by two or more grades of government?)

It is presumed that subcommittees will probably not be discharged till the final report is adopted, since at any time the Joint Committee may refer back parts of its proposed report to the appropriate subcommittee for further study and preliminary drafting.

(F) Death Duties. See detailed suggestions under (E), The Income Tax, above.

(G) Gasoline Tax. See detailed suggestions under (E), The Income Tax, above.

(H) Tobacco Taxes. See detailed suggestions under (E), The Income Tax, above.

(I) Liquor Taxes. See detailed suggestions under (E), The Income Tax, above.

(J) General Sales Tax of Similar Tax. See detailed suggestions under (E), The Income Tax, above.

(K) Other Excises. See detailed suggestions under (E), The Income Tax, above.

(L) Property Tax. See detailed suggestions under (E), The Income Tax, above. It is to be noted that the property tax is the one tax in this list which is, as a practical matter, denied to the federal government by the United States Constitution.

(M) Other Forms of Taxation. This topic should cover both existing forms of taxation not listed as above and also possible new forms. Each such tax which the subcommittee thinks worth considering should be analyzed in accordance with the detailed suggestions under (E), The Income Tax, above.

(N) Bibliography. At the first meeting certain undertakings were made as to bibliographies. It is suggested that this work be definitely assigned to a subcommittee, the results of whose labors should be made available as quickly as possible to the Joint Committee and the subcommittees.

(O) Foreign Practices. It would seem desirable for the subcommittees and the Joint Committee to have information respecting foreign practices or the recommendations or studies of special bodies such as the American Legislators' Association, but it would seem unwise for all the subcommittees to engage in duplication of work in research as to these methods, studies, and proposals. Hence a separate subcommittee should be constituted to collect and abstract this information.

II. Subcommittees

The Agenda Committee suggests that a subcommittee of three members of the Joint Committee be appointed by the chairman to consider each of the fifteen topics listed above. Since there are fifteen subcommittees, each member of the Joint Committee would probably have to serve upon at least two subcommittees. It is believed that this is an advantage of the proposed arrangement, since it would spread out the work and tend to coordinate the investigations of the several subcommittees while in progress.

It is suggested that each subcommittee should promptly organize itself by selecting a chairman, a vice-chairman, and a secretary.

The Agenda Committee suggests that the various subcommittees seek their information and get advice where best they can, using whenever it seems expedient the device of inviting experts to confer with them or of asking experts to prepare memoranda on parts of their assignments.

III. Organization of the Joint Committee

The Joint Committee, it is suggested, should have an executive secretary, who would be employed by the chairman and be given suitable compensation. He would presumably not be a member of the Joint Committee. It would be his duty to keep a record of the meetings and the work of the Joint Committee and, so far as required, of the various subcommittees. He would, under the direction of the chairman, supervise the assignment of work to the various subcommittees and keep in constant touch with their investigations. He would have charge of the collection of materials for the Joint Committee. He would assemble the reports of the subcommittees and all other information and, under the chairman's direction, write the preliminary drafts and possibly also the final draft of the Joint Committee report.

Eventually it may prove advisable to set up a drafting subcommittee to undertake or supervise the writing of the Joint Committee's final report. This matter need not be considered immediately. The decision will obviously be conditioned by the functions of the proposed executive secretary.

IV. Finances

It would seem wise for the whole committee to consider immediately the provision of funds for at least two principal objects: (1) to compensate the executive secretary and (2) to reimburse

members of the committee and of the subcommittees for essential travel expenses incurred in attending meetings (railway transportation and board and lodgings). The Agenda Committee has made a rough calculation and believes that $4,000 will be necessary to cover several meetings of each subcommittee and several meetings of the whole committee. If a good deal of work is done during the summer perhaps some savings can be made by having a subcommittee, when possible, meet at the summer home and as guests of one of its members. The amount required for compensation of the executive secretary will obviously be governed by the caliber of the man chosen, the length of time of his employment, whether part time or full time, and other considerations. The Agenda Committee has not undertaken an estimate of this item. How the money shall be raised is a matter which the committee believes should be left to a special committee, whose members need not necessarily be members of the Joint Committee.

The agenda was considered by the Joint Committee and the following was the consensus of opinion.

General Principles of Report

It was agreed that each of the five general principles proposed by the Agenda Committee should be taken up in order. The binding effect of the adoption of the principles was determined by a resolution adopted in the following language:

"The Joint Committee agrees to the following principles as guides for its subcommittees, but not as necessarily binding on the Joint Committee's ultimate action."

The first general principle offered by the Agenda Committee in the form of a question was as follows:

"Should it be the object of the Joint Committee to recommend an ideal distribution of sources of revenue and of methods of collection for the three levels or grades of government, national, state, and local, with reasonable regard to the ultimate possibilities of partial or complete realization, or should the committee aim to suggest a plan that may be advanced for immediate substantially complete adoption?"

After considerable discussion, amendment, adoption, subsequent reconsideration, further amendment and ultimate adoption, the proposition was made to read as follows:

"It is the object of the Joint Committee to recommend the basic principles of coordination of taxes of the three levels or grades of government, national, state, and local, with reasonable regard to the ultimate possibilities of partial or complete realization, rather than to suggest only such measures as may be advanced for immediate adoption."

The second general principle offered by the Agenda Committee was adopted without major amendment other than to state positively what was propounded by the Agenda Committee in the form of a ques-

tion. It was pointed out that the proposal applied only to the Federal Constitution. As adopted the proposition reads as follows:

"The Joint Committee accepts the existing constitutional allocation of sovereign powers to the federal and state governments respectively, and lays down the premise that the proposals it will make as to coordination of federal, state, and local taxation shall not tend to impair the financial integrity or sovereign powers of either the federal government or the states."

Similarly the third general principle was adopted in the following language:

"The Joint Committee accepts the principle that the primary purpose of taxation is to raise revenue, and that the use of taxation for regulation or other purpose is to be approved only in exceptional cases and when supported by strong argument in each particular case, and that those who urge such other uses of taxation must accept the burden of proof."

After brief discussion, consideration of the fourth and fifth general principles was postponed until the next meeting. The principles as proposed by the Agenda Committee read as follows:

"(4) Will the Joint Committee accept the principle that in general each grade of government should support its functions from its own revenues?

"(5) Will the Joint Committee accept the principle that in general the government (of whatever grade) which raises the tax revenue should have control of its expenditures?"

Drafting Committee

Consideration of the advisability of setting up a drafting committee to undertake or supervise the writing of the Joint Committee's final report was postponed.

Subcommittees

The regular order on the agenda was here resumed and consideration was given to topics for assignment to subcommittees. It was agreed that there should be a subcommittee for each of the 15 topics proposed by the Agenda Committee, viz.:

1. Distribution of the functions of government among the three grades of government.
2. Adequacy of revenues.
3. Deficiencies of present system.
4. Means of achieving uniformity in methods of reporting tax bases for assessments by different levels of government.
5. Income tax.
6. Death duties.
7. Gasoline tax.
8. Tobacco taxes.
9. Liquor taxes.
10. General sales tax or similar taxes.
11. Other excises.
12. Property tax.

13. Other forms of taxation.
14. Bibliography.
15. Foreign practices.

AGENDA OF NEXT MEETING

The existing agenda committee was continued. Motions were adopted making suggestions for including the following subjects in the agenda for the next meeting:

(1) Consideration by the Joint Committee of the desirability and feasibility of having a permanent official inter-governmental advisory body on federal-state relations.

(2) Consideration by the Joint Committee of the advisability of recommending the adoption of some such scheme as that of the English career system for getting the best people in the service of the government.

At the last meeting of the Joint Committee on June 13, 1941, advices were received of the appointment of some members of the committee by the Secretary of the United States Treasury, Henry Morgenthau, Jr., to a committee to work for the United States Government, on the subject of Coordination of Federal, State and Local Taxes. The chairman of this group, Luther Gulick, Director of the Institute of Public Administration, has been sitting in with the Committee of the National Tax Association and its companion committees, and expresses a willingness to continue to sit in with them and at the same time to unite any efforts that might be of mutual advantage in which his group might be engaged.

The Joint Committee is particularly well adapted for a successful undertaking in that it has among its members the representatives of the tax administrators, so that both from the point of view of the federal government, the state and the local governments, persons familiar with the law of taxation, economists actively engaged in university work, and persons representing taxpayers who are vitally concerned with the problem with which the committee is struggling, are in a position to give their best to this problem.

At the June 13 meeting the Joint Committee, acting on the agenda, decided to adopt certain subjects for consideration by subcommittees. These subjects cover the broad field of the problem. Members of the Joint Committee that make up these subcommittees are now in the process of selection and it is the purpose, before much more time elapses, to have the subcommittees working actively in the particular branch of the problem as set forth in the agenda to which they have been assigned.

This report to the National Tax Association, as is clearly manifest, is but a report of progress. The problem submitted to the committee is vast in the proportions and in many of its aspects almost insoluble, but there are those on the committee who feel that something can be done, and while it is not the thought of the com-

mittee that there should be much to-do made about any inconsequential things which may be accomplished, they are of opinion that ultimately a worth-while report can be made from which something of real benefit will develop. It is, of course, to be understood that as the Committee works along and finds some incidental item that can be instantly corrected or improved, it will do so with the thought that something that can be developed which will be instantly beneficial will be desirable to put into being rather than to hold it for some report or, for that matter, to enlarge upon it as something which appears to be an accomplishment. The committee is of opinion that it has accomplished much already. The mere fact that there are now all of the persons who are interested in this problem well represented and that the Federal Government is taking an active interest is in itself an accomplishment. The discovery of the real difficulties in the problem is again an accomplishment because it all leads to the understanding which furnishes a foundation from which that which is of permanent benefit can be developed.

The introduction of national defense requirements has not made it easy for the Committee and possibly may delay the real consideration of the finance problem as between the federal, state and local governments until the national defense financing is completed, even though, during the period of development and perhaps for the first time in the history of the country through the National Tax Association's Committee on Coordination of Federal, State and Local Taxes, the Congress is giving concern to the effect of federal revenue acts on the finances of the state and local governments.

The Committee submits this to indicate that while the accomplishment may not have been great, it has not lost sight of the problem and that it has cleared a way for that which ultimately will be an accomplishment to which the National Tax Association will, it is hoped, be proud to point.

The agenda being accepted, the following members of the National Tax Association have been named to the following committees:

Joint Committee on Organization Acquiring Funds to Determine Compensation:
Gerstenberg, Chairman; Graves, Goes, Gray, Long.

What Distribution should be Made of the Functions of Government Among the Three Grades of Government?
Chatters, Chairman; Graves, Gray.

Means for Achieving Uniformity in Methods of Reporting Tax Bases for Assessments by Different Levels of Government:
Chatters, Fairchild, Gray, Lepawsky.

The Income Tax:
Gray, Heer, Shoup, Stam.

Death Duties:
Edmonds, Gerstenberg, Gray, Stam.

Gasoline Tax:
Edmonds, Chairman; Pierce.

Tobacco Taxes:
Edmonds, Chairman; Heer.

Liquor Taxes:
Edmonds, Graves, Pierce.

General Sales Tax or Similar Tax:
Shoup, Chairman; Goes, Pierce.

Other Excises:
Pierce.

Property Tax:
Goes, Chairman; Chatters, Fairchild, Newcomer.

Other Forms of Taxation:
Pierce, Graves.

Bibliography:
Stam.

Foreign Practices:
Newcomer, Chairman; Gerstenberg, Shoup.

Adequacy of Revenues:
Edmonds, Chairman; Graves, Gray.

Respectfully submitted,

HENRY F. LONG,
Chairman, Committee on Coordination
of Federal, State, and Local Taxes

I have listed here the sub-committees as set up, with the names of those from the National Tax Association on this committee who have been assigned to these various subcommittees, but the sub-committees, of course, have been enlarged by members from these other groups.

I would like to say this in addition: the complete formulation of all the sub-committee groups has been delayed because in a discussion with those who were the most concerned, it seemed to be rather clear that we do need some kind of financing, so that there are two major things which are now going forward. First, the bibliography, which is generally under the direction of Mr. Manning, secretary of the National Tax Association, who is not on the National Tax Association committee, however, but is one of the members appointed

by the American Bar Association. That is being whipped into final shape and will soon be available. As a congressional document it will contain, we hope, information directing one who is interested to all the material which has been published in respect to taxation.

The second — and you have already passed on it in part — is the thought that under the peculiar situation in which the National Tax Association finds itself as an educational institution, there will be through the medium of the treasurer of the National Tax Association the opportunity of receiving some grants of money so that this work may proceed properly. It is perhaps proper to say that at least most of the members of the committee, all who have been asked about it, agree that our best course in order to bring about the best result is to finance a very definite, well-organized plan of getting this information, and that we hope to be able to accomplish within a relatively short while.

Perhaps the third thing—being again a repetition of what I said at the beginning—there is altogether now seeping through all elements of our society the thought that coordination should be accomplished. Each, as I have tried to indicate, may have his own idea of what that coordination should be, but it is there, and perhaps for the first time we have been ahead of the general recognition on the part of the public that there is need for coordination.

Out of the exchange of views that have been established, and out of the general public opinion that there should be coordination, undoubtedly something will come which is of value; but it isn't an easy task. I doubt very much if a solution could even be suggested until we have satisfied all these various elements that are engaged in the effort to find the truth.

At the beginning, I tried to make clear to you that this report was not very interesting, and a rather dull sort of thing to call to your attention, and I was trying to have the story which might illustrate, because one of the things which some of the members of the National Tax Association have from time to time advised me is that the $5 that they pay annually for membership in the National Tax Association is well worth while, merely for the stories that they get out of these conferences, which are made a part of the record; and they say that frequently, being pressed for a good story to tell when they are called upon to speak at banquets and dinners, they merely have recourse to the National Tax Association proceedings, which takes a position even stronger than the Joe Miller joke book as to what should be told in the way of a story.

This story was told to me by a member of the National Tax Association, so perhaps I may be permitted to use it as far as I can, although it isn't entirely apt to this thing that I am now giving consideration to. The story is told, at least, of a boy who developed

to be the black sheep in the family, and it came to be very distressful, and one thing led to another—he got into one difficulty after another, until his family had exhausted all their patience. Ultimately the police had exhausted their patience, also, and the situation became so hot for him—he had so completely outworn all his possibilities of living as a decent citizen in that community, that he was shipped off to Australia by his family.

In the course of time, while the family knew where he was, not having heard from him and not knowing whether he had reformed or not, his father passed away, and his two brothers who lived in the community, who were middle-of-the-road citizens, and also very thrifty, consulted with each other as to whether they should advise this boy down in Australia of the passing of their father. The question of how they should notify him became a real problem for them, because they discovered that the cable rates to Australia were very high. But they finally, upon investigation, discovered that they could send six words as the minimum amount of words for a very large sum, to them, but it could be done, and they finally decided in favor of notifying the boy at least of the fact that his father had passed.

So they finally sent this cablegram to Melbourne: "Jesus took father on Friday night."

In the course of a little while they got a cablegram in six words back from Melbourne: "Jesus who and for how much?"

Chairman Curry: Thank you, Mr. Long.

I am sure the Association doesn't consider that it is necessary to take any action upon the preliminary report, as it merely gives information as to the explorations of the committee thus far.

The next speaker on the program was to be Mr. James A. Maxwell, of Clark University, who was to discuss "The Recent Proposal in Canada—What Happened and Why? The Outlook." Mr. Maxwell is not able to be present, and his paper will be read by the Hon. Dixwell L. Pierce, Secretary of the California State Board of Equalization.

Mr. Pierce.

Dixwell L. Pierce: Mr. Chairman, Members of the Conference: All of us, I am sure, are deeply disappointed not to have Mr. Maxwell here with us today in person to read this excellent paper that he has prepared for us.

I am happy, however, to be able to pinch-hit as best I may. If perchance you find that some of the remarks in the paper are a bit harsh on the subject of the current Canadian scene, I hope you will be kind enough to remember that I am merely a Charlie McCarthy.

RECENT DEVELOPMENTS IN TAX COORDINATION IN CANADA

JAMES A. MAXWELL
Clark University

Coordination of federal-provincial taxation in Canada was not the subject of serious discussion before World War I. The reason was not the existence of a clear constitutional division of authority nor a commendable forbearance on the part of each level of government. The plain fact was merely that the federal government had been under no pressure to find revenue other than through customs duties. In 1913 over 82 percent of federal tax revenue came from this source and almost all of the remainder from light excises. The provincial governments by this time had ventured into taxation of corporations, successions and personal income; but they had not gone far, the unexplored area was large and there was no reason to suppose that the practical separation of sources then prevailing might not long continue. The World War upset this casual equilibrium and the federal government, faced by an unprecedented fiscal task, was forced to enlarge its tax base. By 1921 customs duties brought in only 33 percent of tax receipts, and a manufacturer's sales tax, taxation of corporations and a corporation income tax had been added to the repertoire. The post-war legacy of federal debt was so heavy that nobody seriously contemplated reversion to the earlier situation and therefore the issue of overlapping federal-provincial taxes emerged. The prosperity of the 1920's, however, prevented this issue from becoming acute. Despite the fact that the provincial governments were confronted with new or enlarged duties—notably construction of highways and provision of social services—a thorough-going remedy was never suggested. Taxation of gasoline and motor vehicles provided some relief to the provincial governments; bickering with the federal government brought heat rather than light.

Then came the great depression. It struck with very unequal weight upon the different regions of Canada, falling with greatest severity upon the agricultural west and bringing the provincial governments there close to bankruptcy. In all the provinces the desperate quest for revenue led to levies which aggravated and extended conflicts of jurisdiction and duplicative administration. The tax system as a whole became distinctly inefficient (in the sense that a given revenue was collected at an unnecessary expense and in a manner injurious to the national income).

Corporation taxes provide the worst example. Corporations are taxed by the provincial governments in ways which defy brief description. In addition to taxes on corporate income, other levies are made on such bases as "capital stock, number of business places,

gross revenue, physical volume of operation, period of operation, mileage of track or wire, mileage operated, note circulation, insurance premiums, investments and volume of deposits." These methods "have grown up in a completely unplanned and uncoordinated way, and violate every canon of sound taxation."[1] Provincial governments have devised formulae to catch whatever assets or income fall within their jurisdictions with the result that "investments in different forms of business are taxed at different rates in the same province; investments in the same kind of business are taxed at different rates in different provinces; investments in business operating on a national scale are double- and triple-taxed with no relation to earning power; certain forms of business can be, and are, singled out for discriminatory taxation; tax compliance costs are uselessly and unreasonably increased."[2]

Taxation of personal income and of successions are in less serious case, although here also defects are present. Seven of the nine provinces levy personal income taxes, but the federal government acts as collector in three (Ontario, Manitoba and Prince Edward Island). Only in British Columbia is the definition of taxable income very different from that of the federal tax. Death duties have been a source of provincial and not of federal revenue, and during the 1920's the provincial governments minimized multiple taxation by reciprocal agreements. The depression, however, broke these down and serious hardship to individuals has often resulted.

Tax conflicts have been only one side of federal-provincial difficulty in Canada. A closely related problem is that of responsibility for governmental functions and therefore expenditures. Anyone familiar with the situation in the United States will make no serious error by assuming that parallel problems have existed in Canada. Both Canada and the United States are federal countries with written constitutions which mean what the judiciary says they mean. In 1937 important federal legislation, embodying the so-called "Bennett New Deal", was held unconstitutional. So urgent did issues of federal-provincial relations become that in 1937 a Royal Commission of investigation was appointed, and after nearly three years of study a report was made in the summer of 1940.

The tax recommendations of the Commission were that the provincial governments withdraw from and leave to the federal government taxation of individual incomes, corporations and successions.[3] Only

[1] *Report of the Royal Commission on Dominion-Provincial Relations*, Book II (Ottawa, 1940), p. 113.

[2] *Ibid.*

[3] License fees, real estate taxes and consumption taxes collected through corporations were not to be banned. Moreover, the federal government was to pay a provincial government 10% of the corporate income derived from the exploitation of the mineral wealth of the province.

by such a transfer could equity among the provinces and adequate exploitation of the tax fields be secured with least harm to the national income. In some provinces these taxes are bound to be relatively unproductive; in others they will yield a large revenue but only by tapping income which arises out of the operation of *national* policies. Provincial exploitation is regarded as unfair to the individual taxpayers, unfair to the people of the poorer provinces, and unfair to the nation as a whole.

What is startling is not these recommendations, but the directness and clarity with which the Royal Commission faces up to certain consequences. Many American students would agree that taxation of personal income, corporations, and successions should be on a national basis if the facts concerning these taxes could be viewed in isolation. But inevitably certain closely related issues come to mind. If transfers are made, how can the states handle their functions and service their debt? Would not the transfers endanger the whole basis of federalism? To these coordinate issues the Royal Commission provides answers—not perhaps always acceptable, but clear-cut none-the-less.

The whole plan of the Royal Commission cannot be presented here, but in summary it involves (besides the tax transfers): federal assumption of complete responsibility for employables, and provincial-local responsibility for unemployables; federal assumption of provincial debt; cancellation of the existing unconditional subsidies paid to the provincial governments and the substitution of new subsidies so calculated as to enable each province to provide services up to an average Canadian standard.

What may be of interest to the National Tax Association is to learn of the reception which this plan received. By the time the Royal Commission made its report Canada was at war and the impression in many quarters was that this would provide a reason—or an excuse—for doing nothing. The Prime Minister, Mr. King, was at first in favor of inaction, but in response to pressure, particularly from Mr. Ilsley, the minister of finance, he consented to call a Dominion-Provincial conference in January, 1941. At the conference events moved quickly. Premier Hepburn of Ontario announced his complete and unequivocal opposition even to consideration of the report. Wartime was, he declared, not the proper occasion to raise controversial issues of federal-provincial relations. Besides this main ground of opposition, Mr. Hepburn discharged a number of demagogic barbs at the report. It was, he hinted, designed to preserve shipwrecked provincial bondholders, to give Quebec preferential treatment, to destroy provincial autonomy.[4] Mr. Hepburn was joined in his opposition by Mr. Pattullo, the premier of British Columbia, and Mr. Aberhart, the premier of Alberta.

[4] *Dominion-Provincial Conference*, January 14, 1941 (Ottawa), pp. 14-20.

The position of Ontario (and to some extent of British Columbia) can be explained on one simple ground. As the richest and most industrialized of the provinces, it stood—at least directly and in the short run—to gain least and lose most from centralization. An improved and coordinated system of federal-provincial finance might, in the long run, bring benefits to Ontario, but the gain is prospective while the loss is immediate. The opposition of Alberta cannot, however, be explained on similar grounds. A cool and unbiased calculation would indicate a gain to it from acceptance of the recommendations of the Commission. But Mr. Aberhart happens to be convinced that the ills of Alberta and of Canada can only be remedied by overhauling the monetary system,[5] and he refused to deviate from this goal.

Although the other provinces wished to go ahead with consideration of the report, the adamant stand of Ontario, British Columbia and Alberta made this seem unwise. But before adjournment the minister of finance, Mr. Ilsley, was called upon to discuss the fiscal position of Canada, and this he did in a frank and admirable speech.

The war effort would, he declared, make colossal demands upon the Canadian economy and as a result the federal government, acting for the nation, would find it necessary to extend its taxes without a meticulous regard for what the provincial governments were doing or might do. In order to meet a national responsibility, and in order to distribute the total burden of taxation among individuals as fairly as possible, provincial tax fields would have to be invaded and rates would have to be adjusted as if the federal government were the sole taxing jurisdiction. This was not a threat; it was a necessity forced by the emergency. But before going ahead, the federal government thought it fair to give the provincial governments a chance to meet in conference to consider how the stresses and strains of federal-provincial relations in war-time might be minimized. The chance had, unfortunately, not been appreciated by some provinces.

This courageous indication of what lay ahead did not, of course, lead the recalcitrant premiers to alter their stand and the conference adjourned *sine die*. Politically, however, it put them on the defensive, and it enabled the federal government to go ahead without the necessity of making further apologies.

Three months later on April 29, 1941, Mr. Ilsley brought down his budget. For the first time the federal government began to levy a tax on gasoline (at 3 cents per gallon) and on successions. More important was a proposal about taxation of personal income and

[5] ". . . I submit that those who would wish to rush through these far-reaching measures are concerned primarily with bolstering up the defects of the present financial system. . . . I suggest that our reply to these fiery advocates should be that we intend to preserve our constitution and our national unity and instead to overhaul the financial system." *Ibid.*, pp. 63-4. Speech of Mr. Aberhart.

corporations. In accord with Mr. Ilsley's warning the federal government proceeded to set the rates of its corporation and personal income taxes at the maximum level regarded as reasonable at the time and without regard for the provincial levies. The rate of the corporation income tax was to be 40 percent; the rates of the personal income tax, plus the national defense tax, were to run from 5 percent to 85 percent. But, at the same time, the federal government asked the provincial governments to vacate these fields for the duration of the war and to accept as compensation for this transfer a yearly payment from the federal treasury equal (a) to the revenue "obtained from these sources during the fiscal year ending nearest to December 31, 1940, or (b) the cost of the net debt service actually paid by the province during the fiscal year ending nearest to December 31, 1940 (not including contributions to sinking funds), less the revenue obtained from succession duties during that period,"[6] The second alternative was for the benefit of provinces which had not developed very fully these two tax fields. Seven of the nine provinces indicated promptly that they were prepared to accept the offer. Ontario and Alberta held out, but the expectation is that they also will soon yield.

The scheme was specifically limited to the duration of the war. Within one complete fiscal year after the termination of the war the federal government promised to cease its payments and "to reduce its taxes in these two fields proportionally."[7] The obvious guess is, of course, that this will not happen and that a move made under stress of war will somehow be made permanent. In any case, it seems very likely that, as a result of the tax transfer, the report of the Royal Commission will come up for reconsideration after the peace.[8]

CHAIRMAN CURRY: Thank you, Mr. Pierce.

Any discussion of the paper will be reserved until after the other papers are read.

[6] *House of Commons Debates*, unrevised edition, p. 2552. Municipalities also were required by the offer to vacate these two tax fields.

[7] *Ibid.*

[8] In this brief paper nothing has been said concerning coordination of provincial-local taxation, and in Canada there has been little serious discussion of the problem. Taxation of real property provides 80% of municipal revenue and there is no provincial supervision of any phase of the tax. In the three Maritime provinces and in Montreal municipal income taxes are levied; in Ontario also these existed until 1936, when municipal taxation of income was abolished and the provincial government paid the municipalities an in lieu subsidy. Montreal has a municipal sales tax. A few instances of provincially-administered locally-shared taxes exist, e.g. in British Columbia the revenue from motor vehicle licenses is shared, but the practice is not important. Only with respect to provincial supervision of municipal borrowing is there material which might be instructive to American students of fiscal coordination.

The next speaker has come quite a ways to be with us this morning. He just came in by plane from London to be here to take part in this program this morning. Mr. Luther Gulick, Director of the Institute of Public Administration and member of the staff of the National Resources Planning Board, will discuss "The Need for Coordination and Feasible Areas of Greater Cooperation."

Mr. Gulick.

LUTHER GULICK: Mr. Chairman and Fellow Members of the National Tax Association: It is a great pleasure to be here. I thought we got at least our value in dues from the report of the various joint committees which head up under our excellent Chairman of Joint Committees, Henry Long. I thought his story was just so much, shall we call it, excess profit. We trust it is not taxable, however.

The real reason I came here this morning and have pushed my return trip ahead with great vigor so as not to miss this engagement, which was made many weeks ago in a promise to your chairman and to Mr. Long and to the Program Committee, was that it seemed to me that it was of the utmost importance that those of us who are now at work in the United States Treasury under a mandate from Henry Morgenthau should come here and let you see in person that the desire of the United States Treasury to cooperate in approaching the solution of this problem of coordination of the federal, state, and local tax problems, is a reality, and has back of it something more than merely the statement of the desire to cooperate.

It was about four years ago that Secretary Morgenthau recommended in his annual report to the Congress that there be set up in the United States a joint commission, which would include representatives of the federal government and state government and local government to approach this problem. You will find that recommendation in more than one of his formal printed reports. On a number of occasions when appearing before the Congress as it considered new legislation, the Secretary has gone out of his way to say that every move which is made by the federal government and the Congress to revise or advance or develop federal taxes has important repercussions upon the revenue systems of the states and upon the revenue problems of the localities, and that it is a mistake to go forward without a broad approach in which all levels of government join.

However, it has been very difficult, in spite of that recommendation from the Secretary, and in spite of similar suggestions coming from the bar associations, the National Tax Association and other disinterested groups, to persuade our legislative leaders to go forward along such a broad program.

Therefore, the National Tax Association, the American Bar Association, the American Legislators Association, the Association

of Tax Administrators, and now the Treasury of the United States, have each gone forward with projects in their own area, but with a desire to work out these problems mutually.

I think a look at the personnel which has already started within the United States Treasury on this broad project is a further indication as to what Mr. Morgenthau has in mind. The director of the project is Harold M. Groves. You know him as a lifetime member of this Association, an active state tax administrator, one whose knowledge of the problem, particularly as viewed from the angle of the states and the local governments, is second to none in the country. He has brought in as his associates in technical capacities to gather various parts of the project together such individuals as Clarence Heer, Mabel Newcomer, James Martin, George Mitchell, and others whom you all know, and who have made contributions over many years to the exploration of this particular problem.

Several members of the staff are members of the National Tax Association Committee, and through the courtesy of Mr. Long all of us have been invited to sit with the members of that committee through its deliberations. I think therefore that we can say that at this point you have the weaving together of the threads of interest, and that though it may take two years, or even three years, to work through the elaborate program which Mr. Long has laid out and the similar program which has been laid out under the auspices of the United States Treasury under the direction of Dr. Groves, that nonetheless we have now for the first time in at least a generation a meeting of the individuals who are primarily concerned with this question, with a very excellent opportunity to do the basic thing that is required in order to approach the problem in a comprehensive way.

I hope that during the discussion Harold Groves will be persuaded to say something, as the matter is really under his direction insofar as the Treasury is concerned. I came, Mr. Chairman, because I wanted to hear the discussion. I wanted to renew old acquaintances, particularly of the tax officials in this part of the country, many of whom I have not seen for a number of years, and because I wanted you to know that insofar as I am participating as a consultant in the Treasury in this project, that I feel that there can be no success on the part of the federal government or on the part of the committees which represent rather state and local and other lines of interest, unless we proceed along certain rather clear lines. On these clear lines there are some points on which we are not fully agreed, and it seems to me desirable to discuss some of those here this morning.

In the first place—and to this we are all agreed—we need to have an open mind in approaching these questions. As the chairman just said, another mission carried me pretty far away from these peaceful shores, but it did give me a chance while in England and

while in Portugal to gather certain information together on the tax problems in those two countries at the present time under rather unusual situations, and under unusual conditions.

My first reaction was that we don't know what a tax problem is in this country in comparison with the problems which are being faced in other sections of the world at the present time. We think our problems are rather serious; we think our conflicts are rather embarrassing; we think our needs are overwhelming; we think our burden is crushing. We really live in a paradise, from a fiscal standpoint, compared to the situation which is faced in some other areas.

And this is very striking: the readiness in these other areas to consider totally new and drastic and sweeping readjustments in tax revenue expenditure and governmental administrative programs. I was sitting talking with a man who is to be responsible for the rebuilding of the cities and the destroyed industrial areas of Great Britain when the war is over. He is a great engineer, and the man who built and organized the British Broadcasting Corporation. He is not a radical; he is a conservative. And yet he is starting off by saying that when he has a railway station that has the roof blown off it and a number of the buildings gone, he asks himself the question, Why should there be a railroad station at this point? Why should there be a town at this point? He is putting a question-mark opposite every single thing. We had thought in the past that it was only the wild, revolutionary reformers who put question-marks opposite questions of that sort; that others would be prepared, really, to put the station back where it was and put the roof back on the building and leave matters as they stand.

Throughout the world there is going to be a greater readiness to approach the problems of government and finance with an open mind; and unless we wish to be in the position of being at the tail end of the procession in the world at war, we are going to need to approach our problems with an open mind.

The second thing that stands out very clearly, as you approach this question of coordination, is the necessity of translating the statement of our problems and the statement of our solutions into quantitative terms. It is a very easy thing to get emotional about broad questions—to get worked up terrifically over the destruction of this or the impairment of that. It is a very different thing, when you get the exact measurement in quantitative terms, in dollars and cents, when you are talking about taxes, and to see exactly what the picture looks like on a balance sheet when you put it all down.

The Canadian Commission did a good job on that, and one reason, as Maxwell said in that excellent paper which was just read for us, that the thinking of the Royal Commission was so clear, and its recommendations so crystalline, is that they succeeded in thinking their problem through in quantitative terms. That is something

that we need to do here, and one thing on which your committee is fully agreed, as has just been stated by its chairman.

The next thing we need is comprehensive thinking. We have done too much tinkering in the past. Too many of our studies of the problem of overlapping have dealt with an individual tax here and an individual problem of administration there. One of the most hopeful things in the whole approach that we now have before us in that of the Treasury and that of the National Tax Association, and the American Bar Association joint committees, is the readiness to approach the problem comprehensively, the readiness to take that comprehensive material and be prepared to draw from it specific suggestions applying to individual issues as they arise. In the past we have been a little inclined to deal with these individual issues as they arise without having any agreement on the broad, comprehensive factors. Now we are planning to approach them broadly, without sacrificing the practical question of meeting the individual issue as it presents itself in the light of this broad analysis.

I need say nothing about the need for cooperation; that we have all stressed.

Our problem of coordination and approach to it through cooperation means that we recognize that the solutions toward which we work must fit the genius of American institutions. They must recognize our federal system, and they must not by indirection in the effort to find an easy solution of certain problems of coordination destroy the vital and important aspects of our federal system. Frequently, when we reach across the borders into other lands to get illustrations, we forget that we are passing into states which are differently organized, which cover small areas. I was greatly struck by the fact in looking over the size of the Tennessee Valley the other day to note that the total area covered by our Tennessee Valley Authority is approximately the same as is the total area of England. That is, we face a totally different question here when we are talking about our tax and revenue problems.

We have an empire, we have a League of Nations. To devise plans of coordination which will recognize and make more vital and more virile those aspects of legitimate state and local concern and preserve this unique thing which was brought forth here by our own ancestors and has been cherished through these years, is an important aspect of this question, and one which we cannot deal with successfully except through the cooperative approach.

We need to give more attention to the economic effects of taxation. I am a little disturbed by one of the major premises of our Joint Committee on Taxation, namely, that premise which starts out with the statement, "The taxation should be for revenue only and that only in extreme cases should we consider the use of taxation as an engine of regulation and control."

It seems to me that we need to approach this problem with a recognition that every tax has an economic effect. It isn't possible to levy a single tax, be it a sales or motor vehicle or income or profits or commodities or production tax, which does not have an effect upon the production, the taxpayer, the distribution—the whole economic system. Usually, those who say they believe in taxation for revenue only are proceeding like a horse with blinders. They are saying, "We won't look at these other things, because they are so complicated," but I point out to you that we put the blinders on the horse, and not on the driver, and that the National Tax Association should be in the position of one who is looking at the whole effect of the tax. I will agree with the committee that it is a mistake in many cases to utilize taxation as a technique of control in place of other types of control which are necessary. It is a mistake to use taxation as a method of control when there has been no discussion of the control aspects, so that the control is brought in, as it were, surreptitiously, through the back door, without a consideration of the effect.

But I submit that we must never consider a tax, we must never think of an increase in levy, a decrease in levy, the rigidity of the system, the plan of administration, without stopping to say to ourselves, "What are the economic effects of this particular series of revenues, or this particular change that we are making?"

I think, as a matter of fact, your committee agrees on that point of view, and it is largely a question of emphasis; but perhaps that will come out in the discussion.

Mr. Chairman, I see that I have gone very extensively beyond the moments that were assigned for this part of our discussion, and my purpose in coming here has been to indicate first that those of us who are related to the study in the Treasury are eager to work toward a solution of the problems in real cooperation. We know it is a difficult task. We know that it can't be done except by men who approach the problem without special prejudice, who come at it with an open mind, who are willing to deal in a comprehensive fashion with the whole area, who are willing to look at the quantitative aspects, and who are prepared not only to cooperate but to work together to the end also of the development of specific programs and recommendations.

I thank you very much for this opportunity of joining in your discussion.

Chairman Curry: Thank you, Mr. Gulick. I am quite sure that the conference would enjoy listening to you longer. If you have an opportunity after the discussions start, I am sure that you could add considerably to the discussion of the papers.

We have heard from several very high officials since this conference began, opposing schemes of separation of the tax fields. We have heard the Chairman of the Federal Reserve Board, we have

heard the Governor of the State of Minnesota, and others, and we have heard some whose views clashed materially.

We have as our next speaker a man representing a business which reaches into practically every state in the union—I presume it does reach into every state—who is going to give us "An Integrated and Coordinated Tax Program." Mr. A. R. Kaiser, general manager of the tax department of Sears, Roebuck & Company, of Chicago.

AN INTEGRATED AND COORDINATED TAX PROGRAM

A. R. KAISER
General Manager, Tax Department
Sears, Roebuck and Co.

My experience in handling many different kinds of taxes for some twenty-five years has indelibly stamped upon my mind that—"something must be done!" Our tax structure is chaotic and is becoming worse every day. I believe it is imperative that we intelligently integrate our federal, state, and local taxes if we are to avoid dictatorship.

I will herein attempt to seek a remedy for the ills of our whole tax structure — national, state and local. I am aware that I am attempting a herculean task. The application of federal, state and local tax laws, and their effect on our economy has been my constant concern for many years. Out of this experience has come a crystallization of thought on certain fundamentals of taxation, which I am setting forth herein, with the hope that they may shed some light, and stimulate intelligent consideration of the gigantic problem involved in the administration and application of our federal, state and local taxes.

Consideration of the constitutional and political questions are ignored herein. No attempt is made to stay within the present tax structure. If there are constitutional or political obstructions to this plan, they should be subjugated to the national welfare, so as not to interfere with a necessary and desirable change in our fiscal policies. I am trying to set forth a plan of taxation, applicable to the whole nation, which I believe is feasible, and would be a tremendous improvement over our present chaotic revenue measures.

The opinions stated herein are not official, but are the conclusions reached from my own experience, and personal thinking on this all-important subject, over a period of many years.

The vast expansion of governmental functions by federal, state, and local units, irrespective of necessity, have resulted in governmental expenses far in excess of current government revenue. I would not attempt in our limited time to analyze many of the unnecessary things we allow our government to do. The fact remains

that these activities, good or bad, have created a tremendous tax burden.

The present tax burden on business is well illustrated by a recent survey published by the American Federation of Investors. The study covered 165 leading companies in the United States for the year 1940. It showed that the average tax burden for this group of companies was $3.92 for each share of common stock, issued and outstanding; whereas the owners received as dividends an average of only $1.91 on each share. These taxes amounted to $735 for each employe working for these companies, and $5.70 on each $100 of assets. This study covers the last year of industry in the United States prior to our "all out" efforts on a rearmament program. It shows that for the year 1940 the stockholders, who were the owners of these enterprises, and who supplied the capital, received only about one-third of the earnings of their capital. The tax-gatherer took almost exactly twice as much as the entrepreneurs received.

In 1938 and 1939 the proportions received by the owners and the tax-gatherer were almost exactly the same. In 1938 the tax burden was $2.73 a share, and the dividends paid averaged $1.33 a share. In 1939 taxes were $3.05 a share, and dividends paid averaged $1.62 a share.

In the year 1939, taxes were 53.5% of net earnings before taxes. In 1940 taxes were 55.9% of net earnings before taxes. Taxes are increasing faster than income, and like the bell on a typewriter, we are warned that we are at the margin. These are the conditions which existed before the war emergency got well under way.

In 1941 the proportion of taxes to net income, before taxes, will be even greater. But 1941 is a year of war economy, and should not be compared to prior years, because of its abnormality. Because of the alarming rise of dictatorships, an overwhelming percentage of our citizens realize the present necessity of an "all out" armament program.

The above survey tells only the story of taxes on business, but this burden, large as it is, does not include the total expense arising therefrom. To the direct tax burden must be added the additional expense incurred in complying with the requirements of the law, and defending the taxpayers' rights under the law. This additional expense is very substantial. Our present system requires large taxpayers to file many hundreds of tax returns, when only a few should suffice. Furthermore, from the earnings distributed to the owners, the recipient's personal income tax thereon must be deducted, before the income can enter into the stream of industry. Therefore, the ultimate tax burden on the earnings of enterprises is much greater than indicated by the American Federation of Investors.

The total tax burden on the consuming public was accelerating at a rapid pace, even before the present defense emergency arose. Ac-

cording to the National Industrial Conference Board, the amount of national income paid out, which was consumed by taxes, was 12.3 per cent in 1928. Ten years later, in 1938, it had reached the alarming proportion of 22.4 per cent. For 1938, the last year preceding the war, Britain's taxes consumed 21.7 per cent of their national income. We, therefore, see that in 1938, the last year before Britain entered the war, we paid a larger percentage of the national income for taxes than Britain paid, despite popular opinion to the contrary. But this percentage does not give effect to the large amounts that we spent in excess of taxes collected, while England balanced its budget. This excess is represented in the deficits of the local and state governments, and the alarming federal deficits.

The percentage of the national income consumed by governmental expenditures for the years 1923 to 1939, as compiled by Tax Foundation, Inc., is herewith set forth. "National Income" is the average of the income produced for the calendar year indicated, and the preceding year. For 1939 it is for the year ended June 30th.

GOVERNMENTAL EXPENDITURES AND NATIONAL INCOME, 1923–1939

Year	National Income in Billions of Dollars	Governmental Expenditures			
		Billions of Dollars	Per cent of National Income		
			All Governmental Expenditures	Federal	State and Local
1923	64.6	8.850	13.7	4.7	9.0
1924	69.3	9.395	13.6	4.1	9.5
1925	71.7	9.869	13.8	3.9	9.9
1926	75.3	10.113	13.4	3.7	9.7
1927	75.8	10.453	13.8	3.6	10.2
1928	77.2	10.972	14.2	3.6	10.6
1929	80.9	11.611	14.4	3.7	10.7
1930	75.9	11.943	15.7	4.2	11.6
1931	61.7	12.390	20.1	5.8	14.3
1932	47.2	13.129	27.8	9.4	18.4
1933	41.3	11.284	27.3	9.2	18.1
1934	46.6	13.604	29.2	12.8	16.4
1935	53.7	15.011	28.0	12.9	15.0
1936	61.0	17.009	27.9	14.1	13.8
1937	68.6	17.187	25.1	12.2	12.8
1938	68.0	17.050	25.1	11.1	14.0
1939	66.3	19.100	28.8	13.8	15.0

It can readily be seen that during the ten years from 1929 to 1939 the percentage of national income that was consumed by governments in the United States had increased from 14.4 per cent to 28.8 per cent—an increase of 100 per cent. Of the 28.8 per cent referred to in 1939, over one-quarter thereof represents government deficits.

Only an anarchist would deny that there are certain necessary expenses of government which must be met. Our objective is to discover an equitable basis of distributing the necessary government expense to the public. A considerable portion of the tax burden, but not all, should be distributed, in proportion to the ability to pay—the balance should be applied on a much broader basis.

An equitable tax law should embody the following fundamental principles.

(1) It should be imposed on all business, whether a proprietorship, partnership, trust, association or corporation; on all competent adults; and on all self-supporting minors.

(2) It should be applicable to foreign capital doing business in the United States as well as to a domestic enterprise; and it should be applicable to all persons doing business and earning income in the United States, whether citizens or not.

(3) It should, as nearly as possible, be a revenue measure, and should not be used for political expediency, or social regulation. In abnormal times the control of inflation might be given consideration.

(4) It should provide a stable flow of revenue, adequate to meet normal and reasonable requirements.

(5) It should contain clear and mandatory provisions for enforcement, and provide for centralization, and concentration of administrative responsibility.

(6) It should not conflict with, overlap, or duplicate other taxes. (This is one of the greatest evils in our present system.)

There may be other features which an equitable and integrated tax plan should embody, but it seems that no such plan should overlook these fundamentals.

The conflict and duplication between federal and state tax laws, and the confusion between the state and local governments, led Professor Simeon Leland, one of our eminent past Presidents, to sound this challenge to the National Tax Association at its 1938 annual session in Detroit. He stated: "A convention of states should undertake the development of a fiscal program for the nation. The burdens of taxation are too severe to justify their continued maldistribution. The need for revenue for debt retirement, rearmament, and the program of social welfare during peace time necessitates the development of a productive and a wise tax system not

alone for the central government but for the state and local units as well."

There is a greater need today than ever before for a scentifically correlated tax system. The federal, state and local governments should each confine itself to certain principal sources of revenue. We should also delegate authority for tax administration to that governmental unit best able to perform the function. Certain desirable allocations of the various taxes will approach a proper correlation of our federal, state and local tax systems. An integrated and correlated tax system would be approached by the adoption of the following general plan:

I.

The federal government should have control of import tariffs, and the excise tax on tobacco and alcoholic beverages. It would not be feasible for any other governmental body to collect tariffs. The taxes on alcoholic beverages and tobacco should be uniform throughout the nation. If the taxes on such articles are at different rates in neighboring states, the seed of strife between the states is immediately planted. It would be impossible to police all our state boundaries over which such articles could easily be smuggled. The revenue from tariffs and excise tax on tobacco and alcoholic beverages, by their very nature, are traditionally and rightly associated with the federal government.

II.

Inheritance taxes so often offer serious and perplexing problems of establishing the taxable situs of the estate or heirs. This issue is so complicated that the several interpretations of different state laws has resulted in confusion, bewilderment, and duplication of taxation. Quite often the same estate has been subjected to inheritance taxes in more than one state, as well as by the federal government. It seems self-evident that the taxes on inheritances and estates should be delegated to the federal government, and thus eliminate the hopeless controversy of jurisdiction.

III.

Social security taxes should be levied on a pay-as-you-go basis. They are national in scope and character and should be administered by the federal government. A centralization would make for uniformity of rulings and administration such as definition of wages, benefits payments, and procedures to be followed with respect to benefits. Instead of the 51 different sets of interpretations now existing, we would have one uniform interpretation. The duplication by the state and federal governments of large administrative expenses also justifies their centralization. Economies to the government, as well as to the taxpayer, would be considerable.

IV.

At the present time there are 23 states, two cities and one territory that have a sales tax in some form. I favor the enactment of a national sales tax on manufacturers, wholesalers, and jobbers, at a very low rate, and a national retail sales tax on consumers. The different sales taxes would be paid to the various states. I would make services from utilities and transportation companies subject to the sales tax. I also propose the elimination of the several state sales taxes with rates ranging from 1% to 3%; the elimination of the use taxes; and the elimination of the state and federal excise taxes, with the exception of the excise tax on tobacco and alcoholic beverages. Emergency relief and partial support of public education in primary and secondary schools should come from the sales tax revenues. When the cost of relief decreases, the tax rate should be correspondingly decreased to a rate which would still provide sufficient revenue to cover a part of the cost of our public school system. Nearly all of the school revenue now comes from the property tax. The proportion thus derived should be reduced, and a heavier portion of the burden placed on the consumer. Interstate sales as well as intrastate sales should be subject to the tax. In fact, recent decisions of the U. S. Supreme Court have decided that interstate sales cannot escape the sales tax.

The administration of sales taxes, by the several states, has resulted in innumerable legal controversies over the jurisdiction of the state to tax sales which are completed outside the physical boundaries of the state in question. Different states may take opposite positions on the same transaction, and neither agree with the federal government as to where the sale was made. To eliminate this controversy, and to capture the sales tax on *all* sales, except those exempted by statute, the return must be audited by the federal government, after the return has been filed with the state, and the tax paid to the state. The sales tax return should be audited at the time the federal income tax return is audited. If any error is discovered by the federal auditors, the taxpayer and the state should be notified. The tax should be paid to the separate states in proportion to the source from which the revenue arose. This is accomplished by allocating the tax in the ratio of "sales made to points in the state, to total sales everywhere." In the case of transportation companies, the allocation could be made on the basis of miles traveled in the various states.

The result of this formula would return all the tax from intrastate business to that state in which the business is located. The tax on interstate business would be equitably distributed to the various states from which the sales originated, or the states in which services are performed. It should be remembered that the tax is on the sale. Therefore the tax should be returned to the state in which

the purchaser resides, or the services are performed, as only such acts make the tax possible. The responsibility of distributing the funds between relief, and aid for schools, should be left to the state, which knows its local conditions best.

V.

At the present time there are 41 states, cities, territories, possessions, and the District of Columbia that have an income tax in some form. We should have but one national income tax with, say, one-fifth paid to the states, and four-fifths to the federal government. We should maintain the principles of excess profits tax. This country has generally adopted the principle of levying the income tax on the principle of ability to pay. The ability of a business to pay a tax is based on its income over and above a reasonable return on capital invested, both tangible and intangible. Income tax should be determined on the average income over a period of three or five years. Averaging income over a period of years tends to stabilize the burden for the taxpayer, and results in a fairly steady flow of revenue to the governments. I would apply this principle of excess profits tax to all income arising from capital, whether it is owned by an individual, partnership, trust, association or corporation. The main source of revenue should be the normal tax. The excess profits tax should be graduated slowly, and the rates should not be too high. If the rates are too high a premium on prodigality follows, and to that extent the purpose of the tax is defeated.

We should delegate to the federal government the ultimate responsibility of determining *all* taxable income, and the audit of the income tax returns. If errors in income are discovered upon audit, the state should be notified as well as the taxpayer. This should be the only tax collected against income, and would replace the present federal income tax, and the many different state and territorial income taxes. To compensate the state for the loss from this source of revenue, one fifth of the tax would be paid to the states by the taxpayer. For companies conducting only an intrastate business, all of the states' portion of the income tax from that business would be paid to the state in which it does business. The basis for determining each state's portion of the tax derived from interstate business should be the average of the percentages derived from the following ratios:

(1) Purchases made in the state, to total purchases made everywhere.
(2) Sales of tangible assets and services made to points in a state, to the total of such sales made everywhere.
(3) Salaries paid in the state, to total salaries paid everywhere.
(4) Tangible property located in the state, to total tangible property located everywhere.

This data would become a part of the income tax return, and the allocation between the states would be made by the taxpayer at the time of filing the return. This system would be a more expeditious, a more economical, and a fairer method of determining the taxable income. It would eliminate the great inequality of the distribution of income tax to the states that now exists, when the different states employ so widely different methods of determining the portion of income taxable in the separate states. It would result in a more uniform and equitable distribution of the income tax burden. It would eliminate a great amount of work in the filing of income tax returns, the audit thereof, and in arriving at a settlement. It would result in uniformity of rulings and interpretations in determining taxable income, which is impossible under the present system of separate laws and different interpretations thereof for each state, territory, district, and the federal government. It would raise the revenue with less friction and expense to the various governments, and lift an expensive burden from the shoulders of the taxpayer.

VI.

The federal government should administer the tax on oil, on mineral deposits, and on timber resources. It should be a severance tax instead of an ad valorem tax. If these resources are taxed on an ad valorem basis, it may be necessary to dissipate the resources, in order to pay the tax. There may be difficulty in working the transition at this late date, but these resources should have been taxed by the federal government from the beginning, as there should be uniformity in the control and conservation of these resources. Once these resources are dissipated they cannot be replaced. These resources are not the results of the handiwork of man, but are the gifts of the Creator. There seems to be no logical argument why they should not be taxed and conserved by the federal government. The benefits therefrom should be shared by the nation.

VII.

The revenue from the gasoline, other motor fuel, motor oil and motor vehicle taxes should not exceed the cost of building, maintaining and policing the highways. These sources of revenue should be under the supervision of the various state governments.

VIII.

Occupational licenses should be levied by the state. They should be imposed only on those occupations which the public welfare dictates should be closely policed. They should provide only enough revenue to defray the cost of inspecting and policing the activities so licensed.

IX.

In stead of the various kinds of taxes on capital that now exist in the federal, state and local tax programs, we should have but one uniform tax on capital, payable to the state. It should be imposed on the capital used by every organization doing business, whether as a corporation, proprietorship, partnership, trust, or association. The federal capital stock tax, and its companion, the declared value excess profits tax, should be abolished. The amount of that tax is determined by guess. It requires the taxpayer to look into the future before he can determine his tax. That is neither scientific or reasonable. The good guesser keeps his tax down. The poor guesser is penalized. In this day of fast economic changes, who is sufficiently necromatic to divine the future? If he can't, this tax bites.

The tax on capital should be levied on the capital employed in the state. Capital employed by a proprietorship, partnership, trust, or association would be indicated by the capital account, and reserves which are not in the nature of a liability, or are not a specific adjustment to valuation, such as a reasonable reserve for bad debts or for depreciation.

Capital employed by a corporation would be the amount of capital stock, surplus, and surplus reserves. Surplus should include any adjustments resulting from the federal income tax settlements which have changed surplus. If excessive depreciation has been taken on the books of the corporation, which depreciation has been disallowed as a deduction from income in the settlement with the Treasury Department, this amount should be added to surplus.

Because of the expansion of business into many states, this tax should be audited by the federal government at the same time that the income tax and the sales tax returns are audited. A prerequisite for the privilege of doing business in any state would be the filing of a return, and the paying of a tax in every state in which the business activity is conducted, as reflected in the apportionment formula below.

A return should be filed with the state authorities, which would show the capital, surplus and surplus reserves, as set forth in the balance sheet, and any adjustment made thereto which have resulted from a settlement with the Internal Revenue Bureau, if such changes have not been reflected in the surplus account on the books. The state returns and the federal income tax return should show a summary of the capital schedules. If an audit by the federal government discovers any errors in the capital schedules, the taxpayer and the state should be notified.

For those organizations doing only an intrastate business, the tax would be levied on the total value of the capital employed. For those doing interstate business, the value of capital used in a state would be determined by using a formula derived from the following ratios:

(1) Purchases made in the state, to total purchases made everywhere.
(2) Sales of tangible assets and services made to points in a state, to the total of such sales made everywhere.
(3) Salaries paid in the state, to total salaries paid everywhere.
(4) Tangible property located in the state, to total tangible property located everywhere.

When any settlement with the Internal Revenue Bureau results in a change in capital or surplus, it should be mandatory for the taxpayer to immediately pay the additional tax, if any, resulting therefrom. If the taxpayer has overpaid a tax, a refund should be promptly made.

X.

And lastly, such a plan should leave the property tax, which is the oldest source of revenue, to the local and municipal governments. This tax by its nature is a logical source of local revenue. It should, however, be uniformly distributed on real and tangible personal property. The administration of this tax should rest with the local governments, under the supervision of an intelligent tax commission, except that the valuation of public utilities and transportation systems must be determined by a state tax commission and the valuations equitably redistributed back to the local units.

The plan herein outlined would tend to destroy any incentive for trade barrier retaliation through the use of revenue laws, which now poisons our present economy. It would tend to equalize the tax burden of all citizens of the United States, regardless of the state in which they reside.

This suggested plan would leave the property tax as their principal source of revenue for the municipal and local governments.

The state would derive its revenue from the tax on gasoline, other motor fuel, oil, and vehicles; the sales tax; the occupational licenses; the capital tax; and a portion of the income tax.

The federal government would receive the tariffs; the excise taxes on tobacco and alcoholic beverages; the various severance taxes; the inheritance and estate taxes; the social security taxes; and the main portion of the income and excess profits tax.

In closing, may I make this observation: There probably never has been a time when Congress has so encroached on the revenues of the state and its political subdivisions as at the present. The condition is almost chaotic, and will become progressively worse if Congress does not cease expanding its field of taxation. No federal tax legislation can be well conceived without giving intelligent consideration to the fact that the functions of federal, state, and local governments are closely interwoven.

I again repeat that "something must be done." A permanent committee, provided with sufficient funds, should be established, whose sole duty would be to publicize the plan adopted, and bring it into fruition.

As time passes our fiscal policies become more and more complex, and it will continue to be progressively difficult to establish an intelligent and integrated tax program.

The time is short. We must become militantly active in this kind of a program if we are to remain a democratic society.

Chairman Curry: Thank you, Mr. Kaiser.

I think the conference will agree that Mr. Kaiser should have come along before the days of the Committee on Double Domicile and the Committee on Allocation of Income. He might have solved some of their problems without so much of their deliberation and development of formulae on those subjects.

I find that we have sufficient time for general discussion of these papers, and I shall be glad to hear from anyone who has any remarks to make.

G. B. Clarke (Connecticut): My question is in connection with this proposition that taxes should be for the purpose of revenue only, and not for regulation. I would like to ask if the Joint Committee would like to consider the abandonment of the protective tariff, which has been for the purpose of regulation from the beginning, and not primarily for the purpose of raising revenue. I think that before the committee and all of us get too far involved in this question, they had better consider whether or not they want to take up this matter of the protective tariff. Certainly it is a tax for regulation and not for the purpose of raising revenue.

Mr. Long: Mr. Chairman, of course the answer to that question was in my report. We said, "Only in exceptional cases." The tariff is that exceptional case. It is rather difficult, of course, to say that the tariff is a tax, and only because you broadly use it can you consider it as a tax.

I am going to steal just two minutes, because I am very much interested in what Mr. Kaiser said. In fact, I think his paper was more provocative of discussion than any other paper, perhaps, that we have had, except those of the papers that appealed a bit to our emotions, which we heard at the University of Minnesota. It may be that the University of Minnesota was particularly selected for explosives, rather than this particular hotel.

I can't encroach upon the time, but I do want to call to the attention of the Association the far-reaching implications in Mr. Kaiser's paper. I submit, without attempting to be discourteous, that the conclusions suggested are those of the taxpayer who is particularly

confined in his thinking to the operation of a peculiar kind of property development.

There is just one thought that I would like to leave with you: the suggestion was made, and your presiding officer, Mr. Curry, being more polite, coming from the South, than I, who come from the North, ever can be, relating to the death duties. The states from the very beginning have controlled the laws of devolution, and while there may be some argument, it is probably true that unless we have the laws of devolution on our statute books, the estates of all inhabitants of every state would escheat to the state itself, and there might be some suggestion that in order to cure what Mr. Kaiser calls to attention, we can abandon our laws of devolution, compel the escheat of all of the estates of citizens of our states to the state governments, and remove completely any obligation on the part of the federal government to consider the levying of estate taxes. I submit that as an easy solution of what he makes appear to be a very difficult problem.

Franklin S. Edmonds (Pennsylvania): In the first place, I want to say that I think this has been one of the most interesting forenoons that we have had together in the tax conference.

In the second place, as a member of the Committee on Coordination, I want to express my very hearty approval of the interesting report that Mr. Long gave us. It perhaps is a very fortunate thing for the Association that Mr. Long with his intense pride in the State of Massachusetts is the chairman of that committee. That, I think, is sufficient assurance that there will be nothing done by the committee which will weaken the autonomy or the integrity of the state governments.

I want in the third place to say that I like very much what Dr. Gulick said about the approach to be made to this question. It is to be approached with wisdom, with candor, with openness. I think it is a mistake for high public officials to make utterances that they haven't thought out. I think it is a mistake for the chairman of the Committee on the Federal Reserve Board to announce his proposition that the federal government should collect all of the taxes and the states disappear from the field.

I think it was a mistake a little while ago for a high public official to say that corporations should be satisfied with 6 percent in the way of profit. I got hold of the president of a large industrial corporation that today is working its hardest to fill government orders, that is working on three eight-hour shifts, employing 800 people in each shift, and is really doing a magnificent work, and I said, "How does this 6 percent proposition appeal to you?"

He said, "I have already had a visit from two of my directors to tell me that if it becomes the federal law we must go back to one shift and abolish the second and third shift, and not take any more

orders." Said he, "On the one shift we can make 6 percent, and if that is all that is left to us in the way of profit, then our duty to our stockholders will require that we do not allow the wear and tear on the machinery in the plant which would be necessary if we work the three shifts as we are doing now."

That is a very practical matter; but it illustrates the silliness of attempting to deal with a question as complicated as that is in an impulsive and unthought-out way.

I want second to say that I liked a great deal of what Mr. Kaiser said, and I think it is by having practical men approach practical questions in a practical way that eventually we will work out a conclusion. I am interested in it because it was in my own presidency of this Association that I think the question was first raised in Phoenix, and at that time I passed through a most hair-raising experience with people who thought that it was silly to attempt anything along the line of coordination.

I still think that there is merit in the original suggestion, which is that in these taxes that the federal government and the state governments have both of them equal rights to impose, that there should be some sort of coordination in the administration, and some sharing in the product, to be done in this way: to be apportioned to those states that will agree not to lay any tax in that field so long as they take the federal portion. That preserves the autonomy of the state; it preserves the right of the state to revoke the settlement, and at the same time it provides for an appropriate method of unification.

I went down to Washington, and I saw my old friend Lovell Parker, who took part in these proceedings, and I suggested to Mr. Parker, "Could something be done along this line?" It was his idea that it ought to be tried first with some new form of taxation, and he made the very happy suggestion that it would be well to try it with liquor taxes, because liquor taxes are universal, so to speak —the federal government is imposing heavy taxes, the state is imposing a whole series of taxes, and if that was made a federal tax alone with the right of the state to share, provided the state not lay any taxes in that line, the rights of both forms of government would be preserved, the autonomy of both forms would be preserved, and we could probably work out something that would be very much more harmonious than anything that we have at the present time.

I am not in favor of the states giving up any of their autonomy. I don't think they ought to be called upon to do so. I think it would be a bad thing for government if they were called upon to do so. I do not like this vocabulary that develops from gentlemen who talk around Washington about the various levels of government. The first time I heard that phrase "levels of government" used, was some years ago by the President of the United States, and the implication is always that there is a higher and more important level, and a lower and subordinate level. I don't like that kind of argu-

ment. I think it is a mistaken vocabulary, and I think that people in high places who speak for the government ought to avoid making those mistakes, which irritate people and stir up opposition which otherwise would not be there.

As Benjamin Franklin said at the constitutional convention, it is a problem to be approached with candor and consideration. If anyone suspects that the idea of having the federal government collect a a tax and share it with the state is based upon an idea of making Washington the exclusive level of government in the United States, he will oppose an idea that otherwise may be sound from the point of view of taxation, and I would not like to see that kind of opposition stirred up.

If, on the other hand, we approach it in this way—that here are two branches of our government that have a right to impose certain forms of taxes, both of them need money, but for the convenience of the taxpayer it is a shame that forty-nine authorities should have separate laws, separate regulations, separate administrative officials and all that sort of thing, and from the point of view of simplification we are going to unite, but we are going to unite on a basis that will preserve the rights and autonomies of those who unite, and will then make a division of proceeds upon some equitable basis—along that line I think real progress could be made.

A question has been raised as to whether or not it is right to have any incidental effects for taxation. May I report to you the interesting case of *Rex* v. *Pratt & Terry*, reported in *Uncommon Law*, by A. P. Herbert, under the caption, "A Tax on Virtue." I would suggest that you read that. The book can be obtained, and it is most interesting legal authority.

Pratt was an eminent actress who had an income of her own. Terry was the editor of an economic journal, who also had an income of his own. They married, and lived together for fourteen years, and had three children, living, apparently, in perfect happiness according to the law of the land.

Then the husband committed an offense for which divorce was the remedy. The divorce was obtained, and after the divorce had been issued it was noticed that Pratt and Terry and their three children still continued to live in the same home; whereupon a proceeding was filed in the Court of Kings Bench, as to whether or not this was not a conspiracy to avoid the revenue laws and to indulge in immoral practices. Whereupon the husband gave his testimony; said he, "We in England have a consolidated income tax return. My wife has a large income. I have a large income; when we unite those two incomes and pay our tax, it is very heavy upon us. The surtax is so great that it prevents us from having the freedom of life that we would like. We have therefore decided that we will get all the enjoyment out of an illegal marital status by filing two separate income tax returns."

The judge, who was the eminent Judge Plush, who is continually quoted in Herbert's *Legal Devisions,* decided that it is no crime to avoid a tax, although it may be a crime to evade a tax, and that inasmuch as this tax was in form a tax upon virtue, it was not to be wondered at the people did non-virtuous things in order to avoid the tax.

I am inclined to think there is a good deal of common sense in what Judge Plush says, and if you continue to have these complicated, disorganized, uncoordinated systems of taxation in the United States, you mustn't be surprised if eventually you find people doing unvirtuous acts in order to avoid the injustice.

CHAIRMAN CURRY: It is a right unusual experience for me, coming from Alabama, to have a Philadelphia lawyer and a Massachusetts tax official making speeches on states' rights.

SENATOR EDMONDS: I think, Mr. Chairman, that we taught you the advantages down there of staying in the Union. Now you have heard about some of the advantages of states' rights.

CHAIRMAN CURRY: It took you most as long to do it as you are going to take to convince the federal government about this question.

I understand that Mr. Charles E. Miner, Regional Field Representative of the Public Works Reserve of the Federal Works Agency, is in the audience and would like to make a few remarks.

CHARLES E. MINER: Mr. Curry, Gentlemen: As I understand, my participation in the program this morning is because there has been an interest expressed by some members of the Association in the Public Works Reserve. It is a pleasure to come; I am glad to have been invited. I would like to exchange the courtesy by reducing my remarks to the most compact form possible. I shall discontinue talking in not more than five minutes from now. So that I may do that, I ask you to be tolerant with me when I do not stop to elaborate on points.

My purpose is to present before you that part of the work of the localities, of the counties, of the states, and of the federal government which has to do with planning public work and public service for use in the period after defense or after war—call it what you please.

It is not an effort by the federal government to set up a large bag for distribution by Santa Claus. It is a program by which each public entity shall review what it wants to have done, shall look ahead over a period of years to improvements it would like to create; shall at the same time consider who and what amount will be paid for those improvements, and shall determine itself whether an improvement proposed by its citizens and its officials can be paid for by itself and shall look ahead to the possibility to be realized by yourselves through action in the Congress as to federal and state assistance in public works programs.

It operates under the National Resources Planning Board, the Federal Works Agency, and is activated, so far as a part of its field staff is concerned, through appropriations to the Work Projects Administration. It is not in any sense a centralized program. Its entities by communities and by states are related quite naturally, so that finally there will be a public works reserve within which there is specific information about how much of what, where, and at what cost.

The decisions as to how much of what, and where, will be made as decisions with reference to public works are always made. There is no proposal to pay a percentage of the cost out of one tax raising source or another. There is no determination now that there shall be a percentage participation out of any particular tax funds. It is an attempt to look ahead to what public needs there will be within the next several years; to design those by the persons who locally are responsible for design and for decision as to what will be used with reference to each other; to avoid duplication, to avoid elimination of one item which conflicts with another, to plan what might be done with due regard to what else might be done, and not as an indication that what has been done up to now has been duplicated or that has not thoughtfully been planned out.

It is quite clear, however, that the level of employment we have now under defense will not be needed when defense needs go down. It is obvious to many that the level of employment after the war will not be the same as it is now. No one can forecast to what degree other employment, private industry, etc., will take over and remove from potential relief assistance those persons who are now actively employed in national defense. To whatever degree, however, that might be found necessary, it seems desirable to make plans in advance. If public needs for six years can be laid out now, and if specifications and blueprints can be drawn, so that when the need arises and when you decide through whatever area, shall I say, instead of level of government, a decision is reached to carry on a particular activity, you will know what activity can be embarked upon first, second, and third. If there is a decision by any group or area or entity in government to carry on one program or another, there will be a particularized listing of desirable, tested, well-carried out and thoughtfully-planned services on which large numbers of persons can be employed. If that is large, the work that might be planned for five years could possibly be done in three or four. If conditions are more favorable, and there is some prediction they will be, the work designed for three years or four, might be extended to seven, eight, or nine. The work is being done by a field staff through units, counties, cities, the officials of cities and of counties and of states, and the federal departments, directly under the Unemployment Stabilization Act of 1921, now administered by the National Resources Planning Board, the whole developed into a rela-

tionship to each other, so that one area of government will not conflict in levels or quantity or particularized things with those set up by another.

The Reserve is new. It has no conclusions to present. The opportunity I am happy to thank you for this morning is an early one. I ask of you this: that you consider as you discharge your responsibility for determining how taxes shall be levied, or advising those who bear responsibility more directly for that as to how they might be, that you take into consideration that there is in your community and in your area of government a plan now being carried forward not imposed but beginning with the authority under which it is done, through which a carefully laid out, wisely planned, so far as any human thing can ever be said to be wisely planned, opportunity to review possibilities for public works during the period after the war.

Thank you very much.

CHAIRMAN CURRY: I know that others have thoughts on their minds they would like to express at this time.

H. K. ALLEN (Illinois): Upon several occasions at the sessions of this conference I have heard the doctrine expressed that the taxing power should not be used for other than revenue purposes. I think that our thinking has not been too clear on that subject. One speaker already referred to the protective tariff, and Mr. Long suggested that that is acknowledged as an exception.

I wonder if the proponents of this doctrine would also uphold the position that the regulatory powers of government should under no circumstances be used for revenue?

That is simply reversing the situation. Now, if that be true, you appreciate what it means. That is, that this great body of license charges which we have, which are authorized under the regulatory powers of government, would not be justified to the extent that they exceed the actual costs of regulation, which would throw out motor vehicle license fees and all other license charges to the extent that those charges exceed the cost of regulation.

I think we ought to recognize that government has certain powers over property and income from property, eminent domain, police power, regulation under that, and taxation, and that at times it is perfectly justifiable to use these powers indirectly; and they are, in fact, widely used indirectly.

I don't think anyone here would object to the use of the taxing power, for instance, as it has been used, illustrated by the tax on the manufacture of sulphur matches which were poisonous and harmful to the workers in the factories making those matches, to the tax on the traffic in opium or the traffic in marihuana, and perhaps some of our friends from Wisconsin would even accept the taxes on oleomargine as being justifiable.

It seems to me that we might apply some tests. I would like to suggest these tests: the first one, Is the public interest promoted by this indirect use of the taxing power? Will we promote the public interest by using the taxing power for this particular purpose of regulation? Then, secondly, Can the taxing power be used more effectively to promote this public interest than direct regulation? Finally, Is the taxing power practicable?

If the answer to these questions is yes—emphatically, I should say, it must be—I can see no objection to the indirect use of the taxing power. I would just like to sound this one note of warning, though: I think when we resort to the indirect use of these powers, we ought to use them very cautiously; we ought to be very certain as to what the effects are going to be, and if there is any doubt about it, we ought not to use the power.

That is the statement I would like to get on the record.

Mr. Long: Mr. Chairman, I am very glad to answer the professor, because it brings to my attention that probably there are a great many things that I do not know. But I believe—and I can speak with assurance so far as Massachusetts is concerned—that the regulatory activities to which he calls attention are under the police power of our constitution, and not under the revenue powers.

He mentions motor vehicle fees. The motor vehicle fees in Massachusetts are not regulatory, but are placed there for the purpose of registration, the privilege of registration. It may be that the courts, in the interpretation of the constitution, have expanded the theory of an excise or privilege tax to the point where the people are impatient with it, and it is so easy to be led into the thought that it is regulatory, and springs from the police power and not from the tax power, that I think perhaps we are a little bit upset in the separation between the two.

I think I am reasonably correct in saying that every single state in the union has gone to the Supreme Court to use the police power, which is primarily the only power which you can use for regulation as a revenue measure.

It is true that the measure of the relation between the revenue produced and the cost, out-of-pocket cost, may be difficult to determine, but I think you will find, if you read the decisions, that the courts have consistently held that the amount coming from the regulatory activities springing from the police power must be reasonable.

I know that question has been brought up consistently in respect to insurance companies and the insurance companies are rather consistent in advancing the suggestion that all they are subject to is regulation, when, as a matter of fact, they are subject to the excise or privilege of being an insurance company.

Perhaps I might be permitted for Mr. Curry's benefit to add something else to the record, because this story came to me from one of

people from the Southern states, in the relation between the police power and the revenue-producing powers of the constitution, in the thought that let us at least have the revenue power going ahead and the regulatory power coming behind, and the story is this: that in one of these states, this representative here at the conference told me they have a great many toll bridges, but the toll bridges were free to people passing over them with agricultural products. This farmer started out with a load of manure, and his colored assistant, and approached the first bridge and was stopped by the toll-gatherer, and when he was asked what he had, he replied that he had a load of manure and a nigger. The toll man said, "No toll. Pass on."

He came to the second bridge and repeated this, in response to the question, "A load of manure and a nigger." "Pass on. No toll."

And the third bridge he came to he responded similarly, "A load of manure and a nigger."

Finally the colored gentleman leaned over and said, "Boss, can't you put me first once?"

J. W. Oliver (New York): Mr. Chairman, I am incompetent to talk about the regulatory machines of taxation and others, but it seems to me that there is one fundamental objective that we should have in mind so far as the regulation either social or economic is concerned. That is that there should be a natural corollary of a sound revenue program. I think that the desired social end and the desired economic end should be a corollary of a sound revenue machine.

Chairman Curry: Dr. Gulick, that was directed at one of your statements. Would you like to answer that?

Mr. Gulick: Mr. Chairman, it seems to me that this session perhaps doesn't offer quite enough time to permit a discussion of the point that has been raised here. We are going to have another session of the National Tax Association next year. Let's have a full-dress debate on this question of, Shall Taxes be for Revenue Only? Questions that have been raised here are little parts of the general picture. The question I raised was, Is it possible ever to think of any tax apart from the full effect of that tax? One of the aspects of the effect of a tax is in the economic area. Do those who advocate the levy of taxes for revenue only wish to say that we shall ignore the economic and social effects of a tax, and shall consider only its contribution to the treasury?

When the question of certain taxes on tariffs was mentioned, for example, Mr. Long very cleverly says, "Well, that was the exception we had in mind." Nobody treed him on any others as yet. When regulatory taxes are referred to, he very cleverly resorts to the lawyers' arguments and says that these are not taxes; they are regulations under the police power.

The suggestion was raised that perhaps in time of depression we faced the situation in which we should think about the effect of the tax upon the price level, and that that might constitute an exceptional period.

So, Mr. Chairman, it seems to me that we have come at this question—perhaps I am to blame—in a somewhat backhanded fashion, and that it would be very useful in the discussions for the sake of our joint committee and for the sake of the work that is going on under Dr. Groves's direction in the Treasury, to put this up at the head of the list for major frontal approach at the conference next year.

CHAIRMAN CURRY: I think for your benefit, Mr. Gulick, that during some of the other sessions we have had some pretty good debates already on the very same subject.

WARREN PETERSON (Arizona): I have listened with interest this morning to Mr. Kaiser's paper. I think it was a master paper.

I want to speak for just a moment on the gasoline tax. We have had considerable trouble in Arizona on account of trying to divert the gasoline tax from one thing to another. I have always maintained that the gasoline tax was for the construction and maintenance of highways. Mr. Kaiser in his paper all the way through was trying to get away from the idea of duplication. If I didn't misunderstand him, he said he thought the gasoline tax could be used for construction, maintenance, and policing of the highways. Personally, I don't believe that they need any of the gasoline tax for policing. Every county and every city in this fair nation of ours has policing and enforcing officers. I believe they are able to take care of the policing of the highways, and I think the gasoline tax—I have always contended that, and I still do—should be used for construction and maintenance of highways. The motorist is willing to pay for that; that is what he wants it used for, and I think we should stick to that.

MARTIN SAXE (New York): In these days when we hear so much about "guns and butter," it occurs to me that we might think of a certain gun that has a great reputation. It is called the Maxim. Now, I have a favorite "maxim," which is that what men learn from history is that men do not learn from history. We are going to find in the development of this very desirable program of coordination that we must keep some history in mind. I was rather amused when our dearly beloved friend, Henry Long, stepped away from the tariff. History brings to mind that it was a distinguished Massachusetts statesman who distinctly emphasized that the tariff was a local issue. So I don't know how you are going to get away from that kind of local issue.

The idea that occurs to me, by way of suggestion to the committee, is that in the development of this program, if they would take

it up step by step, and put over one step at a time, I think eventually we can achieve what Mr. Kaiser thinks is a dream, but which I think is a very possible, practical objective.

CHAIRMAN CURRY: Does anyone else have a point to discuss?

ROBERT S. FORD (Michigan): In this question of the objectives of taxation, it seems to me that it helps a little to make a distinction between the primary and secondary purposes of taxation. There is controversy, of course, on that point. There are some people who would include in the primary purposes of taxation not only taxes for revenue, but taxes for economic and social control as well. Others would say that the primary purpose of taxation is for revenue only, and in the secondary purposes they would place those various nonfiscal purposes which would be the economic and social controls.

Whether or not you place the economic and social control under primary or secondary purposes of taxation seems to me to make considerable difference regarding your attitude, and the person who might say that the primary purpose of taxation is for revenue only, would recognize that by classifying control as a secondary purpose, these taxes would have other effects.

A graduated income tax, an income tax not graduated as much as present rates, might be imposed for revenue purposes only; and yet no one could take the position that it would have no effect upon the existing distribution of wealth and income.

May I just take a minute to address one or two remarks in connection with Mr. Kaiser's paper? First, in connection with his four-factor allocation formula: it ought to be pointed out that that formula was recommended by one of the early committees of the National Tax Association studying this problem. As I recall, it was in 1922 that a committee—I may be mistaken—after studying that problem and writing to various people, finally dropped the purchases factor, because they thought there was not enough favorable response for that. They did not say that purchases should not receive consideration in some cases; but for the bulk of mercantile and manufacturing corporations, the Massachusetts formula, property, payroll, and sales, seemed to be the most acceptable.

One other little point: in connection with his suggestion for the allocation or apportionment—distribution, I believe he said—of railway valuations which were to be made by state tax commissions back to localities, it might be well also to pay attention to the practices in other states. It so happens that in Wisconsin and Michigan, where they have central assessment of railroads and assessment by the state tax commission, they feel that that is the best way to handle it. In other states, where they distribute these valuations which are placed by the state tax commission back to the local units, I suppose they feel that way, too. So there ought to be recognition,

I believe, of the advantages of alternative proposals in that connection.

JAMES W. MARTIN (Kentucky): Mr. Long commented on the point made by Mr. Kaiser to the effect that it might be interpreted as representing the taxpayer's approach and perhaps the approach of a taxpayer who is concerned with one particular segment of the taxpayers' problem. I think there is plenty of support for that view, but I would like to point out, and emphasize as heartily as I know how, that on the political side it seems to me that Mr. Kaiser has made a magnificent contribution to this discussion in suggesting that if the federal government is charged with certain duties in respect of audits and in respect of other aspects of the determination of tax liability under perhaps certain state statutes, nevertheless the collection ought to be in the hands of the states. He put it the other way around—that the money ought to be paid to the states.

That has little technical significance, perhaps; but it has, it seems to me, tremendous political significance, and is calculated to make quite a difference in the reception of a suggestion respecting central administration. In other words, it is entirely possible, and it has been demonstrated to be feasible, that the administration can be split into two segments, the administration of assessment and the administration of collections.

I am not prepared, of course, on this short notice, to agree with the particular applications of this principle that Mr. Kaiser has made, without further study; but it does seem to me that that suggestion in itself, which, although it lay buried among other perhaps more momentous suggestions in some respects in Mr. Kaiser's paper, indicates that Mr. Kaiser is not entirely lacking in political sagacity.

MR. KAISER: I just would like to make a remark of reply to Professor Martin's statement with respect to the payment of this tax to the state. I meant that the state should collect the tax. It should be the collecting agency; so, just to clear up that misunderstanding—perhaps it was unfortunately stated, but it was done with the definite purpose of keeping the autonomy of the state; and I thought that by charging the federal government with the duties of audit and information to the states, as to the amount of liability, and charging the states with the duty of collection, there was no sacrifice of the autonomy of the state.

CHAIRMAN CURRY: I see we have another advocate of states' rights.

M. M. DAUGHERTY (Delaware): In the 1924 proceedings of the National Tax Association, there is a remark that seems to me to be worth listening to. In those proceedings there is a person who got up, and he is listed in the proceedings as "Unknown Delegate." The unknown delegate said, "For the last several years I have been

attending these associations, these meetings, and I have heard you talk about this business of fixing up the inheritance tax collections between the states and the federal government. I have heard you talk about it and I have heard you talk about it, and I have heard you talk about it, but nobody seems to do anything. What we need on this proposition is less talk and more action."

Maybe it was the unknown delegate's statement there that prompted the National Tax Association to appoint a committee to go down to Washington and talk the matter over, and when they went down there they found the Washington authorities very, very willing indeed to listen to their story, and they got the 80 percent cut.

I was very much interested in Mr. Long's discussion of appointing committees and studying. I made a little study of this business myself. I began as Mr. Long proposes to begin, by making a bibliography. I found in the last ten years on the subject of coordination of state and federal taxes 61 articles; but I found no action. In other words, the score up to date is 61 to nothing. What we need in this business is action.

I think if Mr. Long and his committee will approach the Washington authorities, they will find them entirely reasonable, entirely willing to work with them. But there is one thing about Mr. Long's study that disturbs me, and that is that he proposes to fix the whole situation up, or his committee,—have a comprehensive review.

I thought when I first began looking at this subject that one of the things we are going to have to do is discuss the reallocation of taxes and functions of government among the various areas of government. It seems to me that that is an impossibly big proposition. We are forty-eight states, and the functions of government within those forty-eight states are allocated differently in each state, and I don't believe that if Mr. Long will wait for his committee to have solved that question, we will get it solved within the lifetime of anyone in this audience. It is entirely too big a proposition.

The other proposition of going to work on this subject seems to me to resolve itself down to two or three things. We haven't had a division of labor such as we should have had. The professoriate, as I say, have made 61 contributions on the subject, and one of the reasons that I hesitate to wish success to Mr. Long in his project is because they have no doubt netted $100 an article, and $6,000 is a pile of money even to the professors. But I see no reason why we should stand in the way. I am willing to be sacrificed myself, if we could get some action on the subject. What we need, it seems to me, is action.

The professors philosophize and they write and they do this, that, and the other. If you will examine all these articles you will find about six or seven ideas, and that is all. There haven't been any new ones brought up in the last several articles that have been written. It looks to me as if we have exhausted the crop. The tax

situation is getting worse with each new tax bill. It looks to me as if in this division of labor it would be a good idea for the administrators who are supposed to be people who can get together and compromise and scheme and work together to take the matter in hand and give us a report. For goodness sake, let's get started. We are just getting worse and worse each day.

Thank you.

ROYAL B. CUSHING (Illinois): Mr. Chairman, I haven't much to offer, but I was much depressed after the luncheon the other day out at the university. I felt it would be hopeless to meet with the governmental committees, and that we would be in the position of the little boy Benjy—you know the story. Little Benjy met a bear. The bear was bulgy. The bulge was Benjy.

I feel much encouraged today, and when good old Massachusetts, Pennsylvania, as well as these Southern states, still recognize state sovereignty, and that the government at Washington, after all, is a government of delegated powers, I think we can meet together, and I was pleased to hear this representative of the government today say that we could meet with open minds and go into this openly and freely and fairly.

Thank you.

JESSE A. MITCHELL (Missouri): It is just a question of a quarter of an hour until the clock strikes, and there are those obviously interested in the report of the Resolutions Committee, which I see on the program before dinner. I wonder if we might not have the report of the Resolutions Committee at this time and be adjourned?

CHAIRMAN CURRY: If there is no objection, we will call for the report of the Resolutions Committee, and take up the discussion again afterwards, if anyone cares to discuss the matter further at that time.

Mr. Query, Chairman of the Resolutions Committee, will now make the report.

MR. QUERY: The Committee on Resolutions and Conclusions submits as its report and for consideration by the conference at the afternoon session the following resolutions:

The first resolution:

> "WHEREAS the National Tax Association has appointed a committee to study and report on the problem of coordination of federal, state and local taxation; and
>
> "WHEREAS a considerable sum of money will be required to defray the expenses of such committee, be it
>
> "RESOLVED that the Committee on the Coordination of Federal, State and Local Taxation be authorized to raise the money necessary to defray its expenses and that all moneys thus col-

lected be payable to the Association, and be deposited by the Treasurer of the Association in a separate fund, to be drawn from said fund by the Treasurer on the order of the Chairman of said Committee; and

"RESOLVED that the Treasurer be empowered to open an account with a bank selected by him, for the purpose of this Resolution, and is authorized to amend the wording of this Resolution to meet the requirements of said bank for the deposit and withdrawal of funds."

The second resolution:

"WHEREAS in 1926, the National Tax Association appointed a committee to confer with the American Bankers Association on the amendment of Section 5219 of the U. S. Revised Statutes (providing for the state taxation of national banks) authorizing the 'Fourth' alternative method which was duly enacted by Congress; and

"WHEREAS the American Bankers Association in its recent reply to the U. S. Senate Banking and Currency Committee questionnaire (dealing with national monetary and banking policy) has indicated the desirability of clarifying the 'Fourth' alternative method in that section provided, and also recommended authorizing the application of state sales and use taxes to national banks; and

"WHEREAS constructive changes have been made in state taxing systems since the last amendment of Section 5219 in 1926, such as the adoption of sales and use taxes by many states and minimum taxes on state banks in taxation measured by net income from all sources by some states; therefore, be and it is

"RESOLVED that the thirty-fourth annual conference on taxation sponsored by the National Tax Association request the president of the Association to appoint a committee of five (two of whom shall be chosen from among the past presidents of the Association) to confer with an authorized committee of the American Bankers Association for the consideration of the amendment of Section 5219 as herein indicated."

The third resolution:

"WHEREAS the Committee on Allocation of Income of the National Tax Association in a report rendered to the thirty-second annual conference on taxation held at San Francisco, California, in 1939, has arrived at certain conclusions and made certain recommendations with respect to allocation formulae where taxes are based on or measured by net income; and

"WHEREAS the said report has been discussed at this conference, now, therefore, be it

"RESOLVED that the thirty-fourth annual conference on taxation submits the report and recommends careful study be given the recommendations by all states and territories of the United States levying taxes on net income or franchise taxes measured by net income."

The fourth resolution:

"WHEREAS the United States of America is now on an 'all-out' war basis so far as defense spending is concerned; and

"WHEREAS the cost of national defense vastly exceeds estimates current at the time of the 1940 National Tax Conference; and

"WHEREAS the people of this country cannot avoid the increasing demands for taxes which the federal government is making and must continue to make upon them; now, therefore, be it

"RESOLVED that is it the sense of the thirty-fourth annual conference of the National Tax Association that all tax-levying and tax-spending branches of government, federal, state and local, should make every effort to curtail expenditures by the elimination of all non-essential activities, by effecting economies in the performance of the essential governmental functions, and by deferment of all projects not a vital part of the defense effort."

Resolution No. 5:

"WHEREAS the present emergency has vastly increased the revenue needs of the federal government; and

"WHEREAS it is agreed that the national interest demands that these requirements be met in the common interest of national defense, therefore

"RESOLVED that it is important that in seeking additional revenues the federal government shape its tax policies so as to preserve the independence and autonomy of our state and local governments; and further

"RESOLVED that the federal government should give due consideration to state revenue needs and to the established sources of state taxation; and further

"RESOLVED that the states should be watchful in this situation and are under definite obligation to make their views known to federal agencies at this period of our history when their tax resources are endangered; and

"RESOLVED further, that while it is to be recognized that some states are at present enjoying a condition of revenue surpluses, this condition will not continue if the emergency should prove to be of long duration, and that all states should unite and present to the federal government their viewpoints of the

impact of federal revenue legislation, present and future, on state and local revenues."

The sixth resolution:

"WHEREAS the National Tax Association has lost one of its most valuable members in the passing of Charles Jesse Bullock, it is most fitting, in view of his peculiar relationship with the Association, which, in the minds of many, represents the core around which the Association for years has evolved, and which is still controlled by the principles that he so firmly established and insisted upon through the many years that he was the counsellor and friend of the Association and its many members, that the thirty-fourth annual conference adopt this resolution, therefore be it

"RESOLVED that the thirty-fourth annual conference hereby make as a matter of permanent record in the proceedings of this conference, not only their deep appreciation and reverence for Professor Bullock, who through many years not only wrote and spoke in ways which made paths easier for those who are engaged in public finance, but who also exemplified the forward-looking and responsive spirit on which the conference is founded; that while he was a strong exponent of the fundamentals which seem not to have varied through the years, he was not unmindful of new aspects of those fundamentals and generously welcomed from all the expressions of means in which public finance could be improved and with unswerving devotion to what he considered the best principles in public finance, nevertheless tested all new proposals in the light of many years of experience;

"RESOLVED further, that a page in the Proceedings of the thirty-fourth annual conference be inscribed as a memorial to Professor Bullock, and that the Secretary be instructed to send a copy of this resolution to members of his family."

Resolution No. 7:

"RESOLVED that the National Tax Association be requested to continue the Committee on Coordination of Federal, State, and Local Taxation, and the Excess Profits Tax Committee."

This is the last one:

"RESOLVED that the thirty-fourth annual conference on taxation, under the auspices of the National Tax Association, expresses its high appreciation to those in charge of arranging for the accommodation and entertainment of its delegates and guests, and particularly thanks all those participating in the program with contributions which evidence painstaking and studied efforts, and are a distinct contribution to tax literature."

CHAIRMAN CURRY: Those resolutions will be considered at the regular meeting of the association this afternoon. That disposes of the report of the Resolutions Committee.

Are there any other matters that should come before the association?

MR. LONG: Mr. Chairman, I am hoping if the time is still available, that the suggestion that Professor Gulick made might be followed out, and that possibly Professor Groves might give us some suggestion as to what his project was as to this problem.

CHAIRMAN CURRY: I am sure discussion will be well worth the time of those who remain; and while it is now almost twelve o'clock, I don't see any reason for stopping the meeting if some wish to remain.

Mr. Groves, would you like to say something?

MR. GROVES: Mr. Chairman, I think the hour is late, and that this has perhaps been discussed quite sufficiently. I want to second the note sounded by Mr. Gulick to the effect that cooperation has to be the keynote of any program in coordination. I don't think there is any doubt about that.

In connection with administration in the State of Wisconsin, I always have observed in state-local relations that what was attempted through the instrument of the big stick never got very far. But when persuasion was used, and compromise, and voluntary procedure, very considerable progress could be made. I think that is true in this case.

I also want to suggest that it is probably necessary for everybody to approach the problem in a spirit of compromise. I think there is a lot of wishful thinking done on this subject of coordination of state and local revenues. Everybody would like to see a very orderly system, and at the same time have all governments have all the powers possible. I don't believe that this is within the range of feasibility. I am inclined to think that there has to be some compromise, which is not to say, of course, that all the compromising should be one way. That isn't compromise at all.

But I have a good deal of sympathy with Mr. Daugherty's view that the score is rather one-sided on this subject. I was skeptical about making an investment in it because of the very large amount of talk that has already been given to it, and the very little achievement in the field. I think that it is evidence of some wishful thinking. I could give some other illustrations.

I think there is just a little wishful thinking when the mayor of one of the wealthiest cities in the United States looks for the federal tax system to solve the revenue problem of the city. I think there is wishful thinking in the view of many taxpayers that one tax blow would probably be easier to take than two lesser blows. And, as I

said before, I think there is wishful thinking in the view that you can have a nice, orderly system and not give up anything.

The view has been expressed that the federal government should gather the income tax and the inheritance tax and the sales tax and still we must have full state and local autonomy. I just don't see the possibility of that. I think that that would inevitably involve a very large surrender of authority. I think an analogy in that respect is one of giving an allowance to a son. A father can give an allowance to the son. He has perfect freedom to spend the $50 a month, or whatever it might be. The only limitations are that the allowance might be decreased at any time if the displeasure of the father has been incurred, and might actually be cut off, and that amount of freedom is not very great. I suppose in order to make the analogy perfect there ought to be ten sons in the picture, each one trying to get the favor of the old man.

But I agree with the optimism of the chairman of the committee that there is possibility for some accomplishment in this field. I think perhaps we should be content, however, with — or at least should be interested in—small gains that are not revolutionary or spectacular. I am inclined to think that without too great a surrender of authority, there might be a great deal of improvement in the mechanics of taxation on the administrative end, without much change in authority, and largely through the instrumentality of cooperation.

I also want to say one other thing that occurred to me, and that is that while I think most of the facts on the subject are in, as Mr. Daugherty perhaps suggested, I am inclined to think that there are a few that might still be gathered. For instance, on the mechanics of taxation, I wonder if we know what the full cost of the administration of and compliance with taxes in the United States is, with breakdown by units of government and kind of tax. Wouldn't that be extremely useful from the standpoint of criticizing the mechanics of taxation and looking toward a mechanism that would involve less strain on the social and economic system?

In conclusion, I want to say again that I very much hope that this whole study can be pursued with the greatest spirit of cooperation and goodwill. This machine here of coordination has been stalled on the road, I guess, for some fifteen or twenty years, and if it is ever going to get into gear, I think that cooperation and goodwill will be the lubrication that will get it rolling.

Mr. Long: I move that the chairman be congratulated on the patience with which he presided at this meeting and that we now adjourn.

Chairman Curry: Thank you.
The meeting is adjourned.

(The meeting thereupon adjourned, at 12:05 o'clock p. m.)

TWENTIETH SESSION

THURSDAY, OCTOBER 16, 2:00 P. M.

Spanish Room, Lowry Hotel

ROUND TABLE CONFERENCE

Edward D. Allen, presiding.

(Presented below are the full texts of all the papers delivered by the participants on this program, exclusive of the extemporaneous remarks of the chairman.—EDITOR.)

RECENT TRENDS IN HIGHWAY FINANCE

WILFRED OWEN

National Resources Planning Board

At the outset I should like to state that my participation at this round-table discussion on highway finance derives from my connection as a committee member of the Highway Research Board in the National Research Council rather than as a member of the staff of the National Resources Planning Board. The views I shall express, therefore, do not carry the endorsement of the Planning Board.

The manner in which highway revenues are raised and spent involves innumerable questions of transportation and fiscal policy; many more, in fact, than could be touched upon in a limited discussion. It is particularly from the transportation viewpoint, however, that I have attempted to review current trends in financial practices, with the idea of evaluating them in terms of their effect upon the ultimate objective of providing the best in transport service at the lowest possible cost.

INCREASING FEDERAL PARTICIPATION

The most significant development in highway finance during the past decade has been the increasing participation of the federal government. Until 1930, federal activity was confined to construction on the federal-aid system, and average authorization up to that date had amounted to approximately $75,000,000 a year. By 1939, however, the upward trend in federal highway expenditures had reached a peak of $1,171,000,000 for the fiscal year; and as a result of this astonishing increase, federal funds available since 1932 have accounted for six of the seven and one-half billion dollars of federal

money authorized during the entire quarter century of federal road-building aid.

What had occurred in these few years to so increase federal participation is largely the story of work-relief activities and other types of depression spending. First, between 1930 and 1935 grants totaling over a billion dollars were made available to the Public Roads Administration for emergency public works construction; and beginning in 1933 a very large part of the work-relief program, particularly that of the W.P.A., was directed to road and street projects. A summary of federal action since 1933 indicates that nearly four billion relief dollars have been spend on highways, and that this sum has accounted for three-fifths of all federal outlay on highways since that date.

In addition to emergency work, however, there has recently been a considerable extension of the regular federal-aid highway program beyond the scope included in the early federal-aid acts. For while federal assistance was at one time confined to the 7 percent system of rural federal-aid roads, beginning in 1933 participation was broadened to include grants for extensions of the federal-aid system through cities, for the improvement of secondary roads, and later for railroad grade-crossing eliminations.

Today, then, the federal government has become a participant not only in the improvement of nearly a quarter of a million miles of main roads, but it has also assumed a measure of responsibility for a secondary road program comprising a further 10 percent of the total rural road system; and federal relief work is reported to have involved a total of 517,000 miles, largely local roads and city streets.

GROWTH IN USER FINANCE

A second trend in highway finance, less spectacular, and probably more important in the long run, has been the increasing dependence upon motor vehicle user taxes. Up to 1920, highways in the United States were supported almost wholly with funds derived from the taxation of property. Today motor vehicle user charges produce a billion dollars a year for highways, which represents a doubling of this source of revenue in little over a decade. And the trend toward user finance has led to toll bridge and toll road facilities on a considerable scale, and to wide acceptance of the theory that the direct beneficiary of highway improvement should foot the bill.

Accompanying these two trends there has been a declining contribution in property taxes, both state and local, and of local revenues in general. Such funds have practically disappeared as a source of state highway support; and the amount of property taxes spent on other roads and streets has been supplanted to large extent by state grants-in-aid to local units of government, by the work-relief program, and by state assumption of responsibility for roads formerly financed by local units.

GENERAL VS. USER REVENUE

From the viewpoint of the taxpayer then, what can be said of these trends in the manner of financing highways? Perhaps the principal question raised has been whether general tax revenues or specific benefit levies are more desirable as a source of highway funds. In other words, is it preferable to include transportation facilities in the category of general government services such as education and defense, and, therefore, to finance them from the general fund; or should transportation rather be looked upon as being similar to the supplying of food and clothing, of which it is a part, and, therefore, financed by the user?

The choice between general taxation and user charges involves, first the problem of obtaining the necessary funds, and of doing so on a sound and equitable basis. Secondly, since the productive resources absorbed in providing highways are extensive, the method of finance should encourage their careful and economic use. In addition, since public highway facilities assist private transport undertakings, it would appear desirable to finance them in such a way as to avoid unfair competitive advantages among different transport agencies, which would lead to an uneconomic division of traffic and incidentally aggravate the already serious railroad problem. Examination of the experience with gasoline taxes and registration fees as a source of highway revenue indicates that these advantages have in large part been realized.

While financing through user charges should lead toward a more economic use of public funds, and toward a more economic organization of the transport industry, it does not follow that the amount which can be collected in user payments constitutes an automatic guide to the amount of public funds which can justifiably be spent for such purposes. For while the economic justification of private outlays can be determined on this basis, the user tax, being established by legislative decision is rather in the nature of a monopoly price; and since highways are an essential service, the amount exacted by the state from those who use the highways may be more or less than could justifiably be invested in such channels. In addition, the collection of user taxes on a state-wide basis does not reflect the demand for specific undertakings. For this reason, regardless of whether financing is based upon general funds or user taxes, there is always the need for careful estimates of the cost and probable value of particular projects to determine economic justification. Nevertheless, the user tax has the real advantage of imposing a broad restraint upon extravagance, because the demand for facilities is tempered by a realization on the part of users that they must foot the bill.

FEDERAL RELIEF EXPERIENCE

In contrast to what is believed to be a salutary trend toward greater reliance upon user taxes, the growing participation of the federal government raises serious doubts that resulting highway improvements are commensurate with the outlays involved. For aside from the virtues which on the whole have been recognized in the regular federal-aid program, including the beneficial concentration of roadbuilding efforts and the adoption of uniform roadbuilding standards and practices, most of the recent multiplication of federal expenditure has been open to the same criticisms directed to the relief experiment in general. For in the highway field the combination of depression and an absence of public works planning made necessary a resort to projects having immediate employment rather than ultimate usefulness as their primary objective, with technological advance being forsaken for antiquated make-work methods. As a result, the desire to create more jobs overcame the desirability of building better roads.

In the post-war period, the transition to peacetime conditions appears destined once again to call for large-scale public investments to cushion the impact of economic dislocations. Federal participation in modernizing the highway system may at that time be far greater than the relief program of recent years. The use of federal funds for this purpose, moreover, in spite of the general desirability of user charges, would be a legitimate exception to the user principle, if the promotion of extraordinary government investments were found in the public interest. In preparing for the possibility of such conditions, however, it is essential that careful and detailed planning of projects should be undertaken now to provide a reserve public works program based upon the best economic and engineering principles.

Reference to the problem of achieving after the war a highway system adequate for modern motor service directs attention to the fact that despite the very considerable expenditure of public funds in the past, the failings and shortcomings of the street and highway system today are only too evident. These shortcomings have not resulted from a lack of productive resources or technical skill. Instead, they are in large part testimony of the inadequacy of financial policies. For a review of trends in methods of highway expenditure reveal more clearly a lack of change than any large-scale movement to keep pace with modern conditions.

DISTRIBUTION OF MOTOR VEHICLE REVENUE

During recent years there has been a trend toward further distribution of state motor vehicle tax collections to local units of government to aid in financing local road and street programs. Today 325

million dollars a year are so distributed, which represents an increase of 100 million a year during the past decade.

In spite of this trend, an acceptable programming of motor vehicle revenue expenditures remains a primary problem in highway finance. The roots of this problem lie in the fact that the state is the collector of motor vehicle tax revenue, while not only the state, but the counties and cities, among others, are charged with the responsibility of providing highway services. Moreover, the need for rural roads at an earlier period demanded the concentration of highway expenditures in rural areas, so that today, although gigantic requirements have arisen for highway modernization in and around congested metropolitan areas, the force of habit has blinded us to the fact that the biggest highway problem today is in the city. Only about a dozen states now grant any considerable share of motor vehicle revenue to cities. At the same time nearly all states grant substantial funds for local rural roads, and there is often an overgenerous distribution of state revenue to local roadbuilding units, without adequate state control. The whole issue of motor vehicle revenue distribution has become more one of political rivalry than of any attempt to cooperate in planning an integrated highway system.

There is no single method or formula by which grant-in-aid policy can be amended in the future to provide an economic financing of highway facilities on a system basis. Some states may find the solution in a consolidation of roadbuilding units, or the establishment of state-local cooperation on the federal-state pattern now operating through the Public Roads Administration and the state highway departments. Others may devise new criteria for determining an equitable distribution of revenues according to relative highway requirements; or the states may assume responsibility for greater mileages of roads and streets. Perhaps the most promising possibility would be the designation of a single system of motor roads which could be fairly supported by user taxes, leaving local roads and streets to be financed with general or property taxes wherever the high cost per vehicle of providing them suggests their usefulness to be more in terms of property or community benefits than motor vehicle ownership. Whatever steps are taken, it would appear necessary to an adequate highway system development that the various government units within a state should work out a mutually acceptable highway expenditure plan based upon transportation requirements.

TREND IN USE OF FUNDS

Many of the financial difficulties which prevent the achievement of adequate highway service represent neither a lack of funds nor a failure to spend them in the right place, but rather a continued resistance to spending them for the right thing. Progress has often been thwarted by administrative and legal obstacles which prevent

a wise application of highway money. Lack of vision has resulted over and again in projects which are obsolete in design before the work is even begun. Hugh investments have never paid a return in efficient transport service because it has been financially impossible to acquire rights of way adequate for future widenings, or because legal prohibitions against "excess" taking of land has made it impossible to protect the roadway against the hazards and congestion created by abutting land uses. The frequent necessity of building new routes to relieve the bottlenecks produced by inadequate roadside controls seldom leads to a permanent solution, for the same condition soon emerges in the new location. The trend toward freeway legislation denying the right of access to highways designated as freeways, is an encouraging step. But there is still insufficient utilization of such authority.

Concerning land acquisition, many states today can acquire real estate only through local road units, and many of these units are still required by law to finance right-of-way costs themselves, despite financial incapacity. In a majority of states, property owners adjacent to proposed highway improvements have the power to delay road development almost indefinitely; and the practice of appropriating funds for land purchase in the same authorization calling for construction of the highway means that the states have never had sufficient funds to meet the cost of a desirably prompt construction program and a simultaneous heavy expense for land acquisition. Moreover, federal aid has always been confined to construction, leaving the right-of-way problem to the states. As a consequence, road programs have generally been governed by the limited possibilities of land acquisition.

The problem of financing adequate rights-of-way has grown to critical proportions with the developing need for large-scale urban highway developments. An immediate financial necessity is the creation of a federal agency with sufficient funds and legal authority to acquire lands necessary for highway improvement, which it would make available to state and local governments on a time-payment basis. This type of set-up would avoid the restrictions placed upon the states with respect to borrowing and debt limits, it would circumvent the archaic and time-consuming acquisition processes of the counties, and it would provide the greatest single possibility of financing an adequate highway program.

SUMMARY

In conclusion, recent trends in highway finance reveal that very marked changes have taken place in the source of highway revenues, including rapidly increasing contributions both from the federal government and from user taxes. With respect to tax incidence, this trend is of primary importance in terms of the shift of highway costs from property owners. In terms of transportation service, the

belief has been expressed that the user tax has important benefits in promoting economic highway development. For the achievement of physical results, however, the source of revenue is obviously of less importance than how the money is spent. Therefore, the fact that trends in highway expenditures reveal a failure to direct proper emphasis to the real problems of modern highway development constitutes the great challenge in the field of highway finance. Without a thorough revision of expenditure policies now, it will be difficult to plan a post-war reconstruction of the highway system which can avoid the unfortunate errors of the past.

HIGHWAY COSTS AND THEIR ALLOCATION AMONG TAXPAYING GROUPS

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The allocation of highway costs has been the subject of at least fifty published reports and professional papers in the past ten years. A bibliography of the leading publications on this subject will be found on page 528 of the 1941 Proceedings of the American Road Builders' Association. The views therein expressed are not alike. To a large extent they vary because of illogical thinking rather than because of the absence of knowledge of basic facts.

On the subject of highway cost allocation there has been a difference of opinion between the railroads and the "highway users", the latter being represented by the trucking interests. The private passenger car owner and the real estate taxpayer have paid little attention to the problem. The controversy has come about because the railroads have lost to the truckers considerable of their less-than-carload and to some extent carload business, especially on short hauls, and more recently on hauls of several hundred miles. The railroads have held that their competitors are able to take business away from them because they are subsidized.

Previous to the publication of the Eastman Report [1] the trucking interests were accustomed to meet the railroads' contention by saying that it wasn't so and by pointing to the sum of all types of taxes paid by motor vehicle owners and related businesses, including property taxes, excise taxes, taxes on real estate including gas stations, private car garages, and any other taxes no matter how remotely related to the ownership of motor vehicles. Many of these taxes are obviously for the support of the government, as are income taxes and corporation taxes; they do not relate to highway use or to highway costs.

[1] *Public Aids to Motor Vehicle Transportation*, by Joseph B. Eastman, former Coordinator of Transportation.

Since the Eastman Report was made public the truckers have found comfort in quoting parts of it because that report concluded that the highway users as a class now pay slightly more than their "share" of highway costs. An examination of the Eastman Report shows that public contributions to highway costs for the period 1921-37 have even exceeded those from motor vehicle users; but by a process of argument, which I am unable to adopt, the Eastman Report concludes that motor vehicles should pay no more than they now do. In other words, the Eastman Report practically said that the public should now be paying 50 cents on the dollar for highway costs and that the motor vehicle owners ought to pay the other 50 cents. Over the 17-year period investigated the Eastman Report said that the public ought to be paying about 59 cents on the dollar and the motor vehicle 41 cents. If the Eastman Report is right, then it amounts to condoning public aid of 50 to 59 cents on the dollar to motor transport.

In this brief introduction I have attempted to picture the background of controversy that has run through the discussion of this subject in the past ten years. It has been a controversy of the railroads and the trucks. The 25,000,000 passenger car owners are not organized and have so far not entered the controversy. The real estate owner has hardly waked up to what has been going on. During the past 20 years transportation facilities of the country have been doubled by expenditures on highways, over half of which came from general tax sources; namely, the sources which are for the support of government—for schools, health and protection.

The purpose of the above is to caution you in your reading on this subject to keep your own thinking straight and to beware of arguments aimed at obtaining a desired objective.

In the rest of this paper I will attempt to set forth some of the methods which have been advocated for dividing costs between highway users and the general public, and to give you my own comments upon their merits.

HIGHWAY COSTS FURNISH THE ONLY SOUND BASIS FOR EQUITABLE TAXATION OF MOTOR VEHICLES

The current policy is to plan the highway budget to keep within the tax yield, or within that portion of it appropriated for highways by the legislature or other governmental group. The present status of motor vehicle taxation is a result of a hit-or-miss development shaped by expediency and the interplay of special organized interests. A rational basis for motor vehicle taxation would be to set rates which will yield a return sufficient to meet that portion of the long-term highway cost which is the responsibility of the motor vehicle users.

WHAT ARE HIGHWAY COSTS

Some hold that highway costs are merely the annual expenditures for construction and maintenance. This basis is unsuited to a long-range study of the problem because annual expenditures vary; in one year construction expenditures may be large and in the next year small. The service lives of the different elements of highways vary greatly.

The annual cost or "accounting" cost is the only fair measure of the long-term highway costs. The Association of American Railroads Report [2] and the Eastman Report both use this approach. It has also been used in other reports, particularly those prepared by the States of Missouri and Illinois.

The cost items included in the annual costs are

Administration and maintenance,
Charge for amortizing capital investment over the life of highway elements,
Interest on unamortized portion of capital investment, and
Taxes on unamortized portion of capital investment.

The trucking interests have attacked the annual cost approach, particularly the items of interest and taxes, which they claim to be fictitious.

The Eastman Report used the annual cost approach, included interest charges and taxes, but deducted taxes on highway plant before drawing conclusions; taxes are in the computations but only for "illustrative" purposes. Although the trucking interests disclaimed the annual cost method prior to the release of the Eastman Report, they have since given this report wide publicity because its conclusions were favorable to them.

The Illinois and Missouri studies used the annual cost approach, including the item of taxes. The Illinois study showed various combinations of cost items with and without interest and taxes, finding in each case that heavier classes of vehicles were underpaying.

A recent study in Utah assessed "taxes" against commercial vehicles but not against passenger car users.

Whatever method is used to determine the annual cost, it must include all of the physical highway system—state highways, local roads and city streets. Although separate in jurisdiction they are one in forming the highway transportation network. In the allocation the parts of the system may be treated differently, but in the first place their total costs must be appraised. The Eastman Study and the Association of American Railroads Study both adopted this basis.

[2] *Highway Costs. A Study of Highway Costs and Motor Vehicles Payments in the United States*, by C. B. Breed, Clifford Older, W. S. Downs.

One of the elements of annual costs depends upon such uncertain factors as average life of highway improvements and their salvage value. The state-wide highway planning surveys are developing facts on these subjects, which, if intelligently used, will make possible a determination of these factors with sufficient accuracy. Many studies have failed to reach definite conclusions on the plea that adequate information was lacking. If this were true in the past, it is no longer true.

DIVISION OF COSTS BETWEEN MOTOR VEHICLE USERS AND THE GENERAL PUBLIC

General taxes provided road funds prior to the motor vehicle era, and nearly all studies (if not all) still assign some portion of the cost to the general public. The demands of the motor vehicle for highways so exceeded that of the horse, and the facilities required for this new vehicle proved so much more costly than those formerly required, that it soon became necessary to obtain a large measure of highway funds from the motor vehicle user. Today the use of highways is almost exclusively by motor vehicles, hence it is self-evident that they should share substantially in the cost, and probably should pay all of it. The extent to which they should share has been appraised in different reports on a number of different hypotheses, as follows:

(a) By extending the same per capita cost of highways and streets existing before the motor era into the motor vehicle era, and charging that amount to general taxes.

I believe that this is the maximum that the public should pay. Every year highways and streets become more and more an agency for motor vehicle operation. The cost of the right-of-way should be borne by general taxation, but the improvements made upon it for transportation purposes should be charged to the motor vehicles which now use these improvements to the practical exclusion of all other uses. Public services, such as water pipes, sewers, electricity, gas, telephone, do not make use of the improvements made necessary for transportation; they merely use the right-of-way. They have nothing to do with the pavement or of other elements of highway transportation cost. Some writers have held that because these public services lie in the same right-of-way as roads the public funds should contribute largely to road costs. The logic in this is not apparent.

(b) By finding the average cost per mile of road before the motor-vehicle era, and then charging to the public the percentage which the pre-motor-vehicle road cost bears to the cost per mile of roads required today for motor vehicles.

This method has no advantage over the first one. It can only be applied to state highway systems because cost data are not available.

(c) Comparing use of roads and streets by motor vehicles with that for other purposes, such as by pedestrians, horse-drawn wagons, public service lines, etc., and appraising the relative value of such uses as a measure for dividing costs.

This method is unsatisfactory because the " value " of a highway for the different purposes enumerated is too intangible. Another fault in this method lies in the fact that the cost of pavements and other highway elements has nothing to do with the public " value " derived from using a highway right-of-way for the locus of a water pipe, gas pipes, etc. The use of highways for horse-drawn vehicles is negligible; the same is true for pedestrians when one appreciates the fact that most of the highway funds are spent on roads which have no pedestrian sidewalks.

(d) On the basis of traffic use, distinguishing between " local " traffic originating and destined within local communities and " general " or through traffic passing through the community. The general public is charged a percentage of cost equal to that which local traffic bears to the whole traffic.

This method arbitrarily charges the public for the cost of the pavement over which short trips are made, and charges the motor vehicle for the pavements over which long trips are made. There appears to be no logical basis for this. The benefit to the individual derived from a short trip may be greater than from a long trip. Just because he travels a short distance is no reason why general taxes should present him with a road. This method appears vague but has been applied in a study of street use by the Oregon Highway Department.

(e) On the basis of " access to land " vs. highway use. By this method the public is only responsible for providing the right-of-way, and the highway users are responsible for the cost of the roadway and surface which they use. This I believe is basically sound.

(f) On the basis of the value of benefits received by motor vehicle users vs. those received by abuttors or society in general. The Oregon report attempts to use this basis. Obviously, the result depends upon arbitrary values given to benefits.

(g) On the theory that local roads and city streets are " land service " roads and therefore should be supported by general taxes. State highways and the more important rural connecting roads are assumed " general service " roads to be supported by motor vehicle revenue.

A large proportion of the cost of secondary roads is charged to general taxes. This theory is weak because a good road does not

grow any more crops nor cause cows to give any more milk. They merely provide transportation services available to everybody. Obviously they are of great benefit to abutting landowners compared with poor roads or no road. This would be just as true with respect to any property whether it be along a state highway, a city street or a county highway. Because a highway is for the first time improved is no reason why its costs should be assessed on its abutting landowners, or the owners in the general vicinity.

In the Association of American Railroads Report the per capita cost method was used; it was also used in Missouri and Illinois studies. The Eastman Report discussed a combination of methods, but its final decision was mostly arbitrary since it did not adopt any one method. The figures in that report were greatly distorted by the use of a cost index, by evaluating the highways constructed before the motor-vehicle era at a figure twice their actual cost and thus reducing the difference in cost between the present and older roads.

In applying any of the above methods, state highways, local roads and city streets are analyzed separately because the character and amount of traffic and the types and costs of pavements differ. In general these reports assign a larger share of state highway costs to highway users than of the other systems. Combining these systems for a general average we find that the Eastman Report assigns 40 to 50 per cent (depending on the year) to motor vehicle users, whereas the Association of American Railroads Report and other reports assign from 68 to 79 per cent.

The Association of American Railroads and Eastman Reports are not far apart on the total highway cost but they differ markedly in the amount assigned to motor vehicle users. When motor vehicle interests use Eastman data as a basis for claims that they pay more than their share of highway costs, it should be borne in mind that Eastman charged them *less than half* of these costs in spite of their universal use of highways and streets, in most instances for gainful occupation. Also, it should be remembered that right-of-way costs were not included in the computations; these being treated as a public inheritance or gift from the past.

WHAT ARE HIGHWAY TAXES

Motor vehicles pay two general classes of taxes — user taxes (gasoline and license fees) which relate to their use of the highways, and general taxes for the support of government (excise, sales, property, etc.).

It is the former class of payments which should be the basis of whether or not highway users pay their share of highway costs. Whether the other taxes are too high or too low must be judged by other standards. The highway user interests frequently play up *all*

taxes against highway costs, which is not a fair comparison, since if all their taxes were devoted to the highways they would be contributing only to the facilities which they use and nothing to the general support of government.

ALLOCATION OF MOTOR VEHICLE'S SHARE OF HIGHWAY COSTS TO DIFFERENT VEHICLE TYPES

Obviously the type of highway facility required by different types of vehicles is not the same, nor is their use of the highways the same. A 12-ton capacity tractor-semi-trailer demands much more highway service than does a light Ford passenger car. Not only is the former 10 to 15 times heavier, but it usually travels 5 to 10 times as far per year.

A combination of two bases for allocation among vehicle types have been used:

(a) the cost of facilities required for varying weight groups,

(b) the amount of use of the highways by different types of vehicles.

In method (a) it is necessary to evaluate the cost of a road for each weight of vehicle and then assign the increments of cost to those vehicles requiring them.

In method (b) the costs are assigned in proportion to a use factor such as vehicle-miles for that portion of cost not affected by the weight of the vehicle and ton-miles for that portion which is influenced by weight (such as pavement and bridges).

The Eastman Report used a combination of methods (a) and (b) but gave more emphasis to use expressed in vehicle-miles than to weight.

The Association of American Railroads Report used a combination of methods (a) and (b) but found a much larger cost responsibility for the heavier types than did the Eastman Report.

Other reports, Missouri and Illinois, have used ton-miles for allocating all costs, thus greatly simplifying the allocation.

In a recent report the Maryland State-wide Highway Planning Survey employed ton-miles.

All reports are in agreement that the heavy commercial vehicles should pay substantially more than the light passenger cars.

The Association of American Railroads Report found that the heaviest truck-trailer combination should pay 65 times as much as the passenger car, whereas the Eastman Report found a ratio of only 21. In my opinion the Eastman ratio is too low, since in making decisions on doubtful points the Eastman Report has consistently given the benefit of the doubt, i. e., "the breaks", to the heavier vehicles.

During the 17-year period 1921 to 1937, the Eastman Report found that the annual cost amounted to an aggregate of about \$25,500,000,000; the Association of American Railroads Report found it to be about \$31,000,000,000, or a difference of approximately 22 percent. The Eastman Report found the annual cost at the end of the period, i.e., 1937, running about \$2,000,000,000; the Association of American Railroads Report found \$2,300,000,000, or a difference of only 6 percent. These two figures are basic facts which are not far apart. It is when we take the next step of dividing these annual costs between the motor vehicle owner and the public that the reports differ. The Eastman Report assigns the public 50 cents on the dollar and the Association of American Railroads Report assigns the public from 21 to 32 cents on the dollar, the latter being based on the amount per capita that the public was willing to pay for all highways prior to the influence of the motor vehicle extended into the present period up to the year 1937.

How much of this total highway cost should be assigned to the general public and how much to motor vehicles as a class requires logical thinking uninfluenced by present public policies. This step having been taken, the allocation as between different types of motor vehicles again requires logical thinking and knowledge of the facts relative to the cost of highways which are required for heavier vehicles compared with the cost that would have been required for lighter vehicles. Herein is a step that the layman cannot be expected to judge; it is something that must be settled by the engineer. Unfortunately there is some differences of opinion on this subject, even among engineers.

The extent to which different classes of motor vehicles make use of road surfaces for gainful purposes does not enter into this last step in the allocation. Only the cost of pavements required and the use made of them enter into the problem of allocation. It may be logical and in the interest of the public, however, to charge these vehicles which make a special use of the highways for private gain a greater amount than otherwise would be charged. This greater amount, however, is in the nature of a tax on business and therefore should fall in the class of general taxes; such as excise taxes, income taxes, and gross receipts taxes. Such taxes should relate to the quantity of business done or some such other elements of benefit, and not to the cost of producing transportation, i. e., to highway costs.

In conclusion, it is my opinion that we have reached, or are fast reaching, the point where all highway costs should be paid by motor vehicle owners except the cost of rights-of-way which should be provided from general taxes, since the latter are required for access to property and for many public services. Practically all highway costs are for the purpose only of providing a way on which to safely operate motor vehicles.

DISTRIBUTION OF HIGHWAY COSTS AMONG TAXPAYING GROUPS*

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All efforts to resolve the controversy concerning the allocation of highway costs among taxpaying groups have proved inconclusive. Failure to reach agreement on these issues which affect broad segments of the public interest, as well as the financial stability of important privately owned enterprises, stems primarily from two sources. There has been a persistent and wide-spread confusion regarding the basic purposes and the actual beneficiaries of road provision. And there has been a tendency to treat the problem of allocating highway costs as an isolated phenomenon.

If the specific problem of highway finance is to be viewed in its true perspective as constituting only one of the many complex elements of highway policy on the one hand, and of the general transportation policy on the other, three basic determinations must be made.

First, what are the fundamental political and juridical characteristics of the entire highway function?

Second, what specific purposes are served by public roads and according to what patterns are the values generated by road use distributed throughout society?

Third, to what extent are the issues involved in the subsidy controversy attributable to or explained by the conflicts arising out of the co-terminous operation of publicly and privately owned transport enterprises?

Political and Juridical Nature of the Highway Function: Road services have always been supplied by government as one of the essential public functions. Only occasionally has any significant portion of the responsibility for road provision been entrusted to private enterprise. And on those occasions the delegation of responsibility has been accompanied by rigid and comprehensive public supervision.

The common law doctrine, "right of passage," underlies the entire highway function. This doctrine, in turn, is a constituent element of the theory of political sovereignty around which the structure and functions of modern government have developed. It is axiomatic that sovereignty can be preserved only if the state and its citizens alike possess mobility. The minimum requirement, on the one hand, is that the state and its agents have access to all parts of

* This paper is based on the analysis and findings contained in a study of *American Highway Policy* scheduled for fall publication by the Brookings Institution.

the territory over which authority is to be exercised, and on the other, that the citizens be guaranteed avenues of access to their homes, places of business, and to the places where government functions are carried on. Thus, the individual now, as under the common law, cannot be denied access to the public road, nor can the state discriminate against an individual by withholding or limiting the right of passage. Moreover, the state is required to maintain public roads according to standards fixed by statute and judicial interpretation. And mileage once designated as public can be abandoned only after those parties whose interests are directly affected have been given an opportunity to be heard.

It is highly important that these political and juridical characteristics of the highway function be kept firmly in mind; for they impose important limitations upon the type of managerial and pricing policies that can be applied appropriately to the provision of public roads. So long as these underlying characteristics of the road function are preserved they will automatically determine some of the essential economic and social purposes and beneficiaries of road provision.

Purposes and Beneficiaries: The modern road plant is a multiple-purpose facility producing services that are distributed extensively though not uniformly throughout society. When the highway system is viewed in terms of the physical plant and standards of development, it is apparent that the road system as a whole has been developed to serve four more or less distinct purposes: (1) Access to land is basic to the entire road function and every physical segment of the road plant serves this purpose to some degree. (2) There exists a community service function which extends throughout the physical range of the road plant. (3) There exists in a sharply limited segment of the total road plant a general-purpose function—of inter-community transportation—which has been superimposed on the two other purposes served by road development. (4) All roads serve a variety of governmental objectives.

It is also apparent from analysis of the character and extent of road utilization that the several distinct types of benefits which flow from road use are distributed unevenly among identifiable groups of society:

Landowners and occupiers enjoy the principal benefits of the land access service. The individual landowner has a direct interest in the road which serves his property and an indirect interest in other roads.

The community service values produced by roads are distributed widely among the residents of particular communities. The benefits enjoyed by individual residents have no direct relation to land ownership or motor vehicle use.

General-purpose, inter-community roads, produce a wide variety of benefits that are enjoyed by society as a whole. They facilitate

land access and community service, as well as provide inter-community transportation. Motor vehicle users as such, however, derive the principal direct benefits from this class of road, the standards of development being formulated primarily in terms of economies in motor vehicle use.

The government's use of roads is also varied in character. The administration of various essential functions of government, such as postal service, education, and national defense, involves varied degrees of direct use of all segments of the road system; and in some instances it necessitates the provision of additional facilities not needed for ordinary private purposes.

These fundamental purposes, as well as the broad grouping of beneficiaries, have remained relatively stable throughout modern history. It is only the mode or vehicle of utilization that has changed to keep pace with technological advances in the methods of producing and distributing goods, and with the broadening concepts of governmental responsibility. Thus, the universal substitution of motor vehicle for horse-drawn transportation has tended to center attention upon the mode rather than the purpose of highway use. As a result, recent trends in highway management have been dominated by a superficially attractive but invalid theory of highway benefits. It assumes not only that there exists a special class of society, namely, motor vehicle users, which is the exclusive beneficiary of the values created by the road plant, but that the various types of users constituting this class of society have a common interest in all classes of roads.

This oversimplified theory of the highway function has gained acceptance at an accelerating rate during the past decade. But it must be rejected as an over-all solution for the problem of highway management. The basic problem in the distribution of the financial burden of road provision is vastly more complicated. Any sound plan must devise some system of road management that will on the one hand prove administratively feasible and on the other will permit full recognition of the observed economic and social characteristics of the road plant.

It is of course apparent that the state has not provided separate, or physical distinct, systems to serve each of the four major purposes of road provision. But certain segments of the total road plant have in fact been designed to meet the varying requirements of fairly distinguishable groups of beneficiaries. Thus, at one extreme there is an extensive mileage of relatively unimproved roads whose predominant purpose is to furnish access to land. At the other extreme there is a limited mileage of highly improved roads whose predominant, but by no means exclusive, function is to furnish optimum inter-community mobility. (Measured in terms of the economies of time, safety, convenience, and operating costs.) In between these two extremes lies a twilight zone of mileage which

serves partly to enable the residents of individual communities to gain access to main arteries of travel; partly to facilitate purely community travel—from the home to church, school, the market place, and places of employment; and partly in common with all roads to give access to land. In spite of the varied purposes of the travel carried by these intermediate types of roads, interest in their condition and extent is centered primarily in the community.

These are the underlying considerations which recommend adoption of road classification according to predominant purposes as the keystone of a sound system of road management. The first step is for each state to designate, according to scientific criteria, a system of general-purpose roads with primary jurisdiction vested exclusively in state agencies, and with the major financial burden assigned to motor vehicle users. Inclusion or exclusion of mileage in these general-purpose systems, as well as standards of improvement, would be governed exclusively by criteria of inter-community mobility.

As a necessary corollary to the principles on which the general-purpose system are to be constituted and developed, an appropriate system of user charges would have to be designed to compensate the state for the actual costs incurred in the provision of these physical facilities. The highly diversified physical characteristics of motor vehicles require a system of levies designed to measure differential road occupancy as well as incremental costs.

Differential road occupancy arises from the fact that highway traffic is composed of two fairly distinct classes of vehicles. One class is able to make full use of a high cost facility that has been provided by the state to facilitate optimum inter-community movement of goods and people. Some units of the other class, composed largely of heavy trucks and buses, are unable to maintain average speeds. Consequently, they impose a drag on the traffic movement at the points that are vulnerable to traffic congestion. These points normally occur in areas where topography or urban developments impose prohibitive costs on the type of highway location or design that would tend to minimize congestion.

Incremental costs arise from the fact that a basic highway must be designed to accommodate vehicles which vary widely in weight, length and height characteristics. The extent to which the state incurs incremental costs because of the requirements imposed by vehicles of extraordinary physical characteristics is a point of controversy. That some additional costs are incurred is generally agreed. Consequently, this factor must be recognized in the distribution of costs among taxpaying groups.

Charges on gasoline consumed in road utilization furnish a reasonably satisfactory measure of the dynamic factors of highway occupancy. They must be supplemented, however, by charges designed to distribute equitably (1) the fixed capital costs of general purpose

roads which are necessarily incurred regardless of the volume of individual vehicle operation, and (2) the incremental capital outlays incurred because of the additional facilities required to accommodate vehicles of unusual operating or physical characteristics. Even if added costs are not actually incurred on account of such vehicles it may be found that their utilization of the standard road plant tends to lower the level of general utilization and justifies the imposition of a penalty charge to compensate for differentials of road occupancy.

Once the general-purpose road system has been properly classified in each state, administrative and financial responsibility for the remaining road mileage falls automatically into the jurisdiction of local units of government. The standards of development for community service and land access roads will be determined (1) by the expressed judgment of land owners and occupiers with regard to the effect of land access road development upon the profitability of land use and (2) effective community demand for improved standards designed to meet the mobility requirements of local community life. Consequently, the cost of such facilities should be supported by a general tax levy on all rural property supplemented by such general funds as each community deems appropriate for the financing of general community services.

There is no formula by which such determinations can be made. They must be arrived at as an integral part of the functioning of each local government, involving the decision as to the amounts to be applied to road services by comparison with demands for other services normally supplied by local government. In selecting the appropriate unit of local government to supervise the community service and land access portion of the road function it must be kept in mind that the smallest effective administrative unit for road management is one which can command professionally competent personnel, proper equipment, and an adequate operating budget. The township unit has been found wholly inadequate to meet these requirements. In most states the county or some corresponding unit has been found best adapted to this purpose.

It will be noted that the plan proposed here does not assign directly to motor vehicle users any portion of the cost of community service and land access roads. In taking this position it is fully recognized that these road facilities generate values of direct benefit to motor vehicle users. However, a properly designated general-purpose road system automatically provides direct access to a substantial proportion of rural land, dwellings, schools, and churches, and in addition carries a substantial volume of purely community traffic. Consequently, by assigning primary responsibility for the general-purpose road system to motor vehicle users, local communities are relieved to an important extent of road costs which they

would otherwise have to incur. Therefore, the direct contributions made by motor vehicle users to general-purpose roads would appear to be more than ample to offset the incidental user benefits generated by community service and land-access roads.

Road classification, according to predominating purpose, makes no specific allowance for governmental utilization of the road plant. To deal with this problem, financial adjustments must be introduced at two points: Between the federal and state governments on the one hand, and the states and their local subdivisions on the other.

Federal-state financial adjustments are necessary because the federal government, rather than constructing and maintaining its own national system of highways, has depended upon state-owned road facilities for the administration of those national services which are affected in one degree or another by the standards of road development. In some cases the proper performance of these federal functions calls for a standard of development which would not be provided by all the states merely to serve their own purposes. Moreover, some national functions, such as defense, involve extensive tax-exempt utilization of the general-purpose system which, according to the principles proposed here, would be supported primarily by direct charges on private motor vehicle users. Consequently, the basic system of state and local financing must be supplemented by federal contributions.

Under the constitutional precepts of distributed powers, the federal rôle in the highway field should be directly limited to those types of activities which are designated to serve truly national objectives. If this is done, the resultant costs are properly chargeable to the general funds. If, on the other hand, federal aid outlays for the general-purpose road systems are permitted to expand unduly, the practical effect would be to transfer to the general taxpayer, capital costs that should be borne by the motor vehicle users in each state. It would then be necessary to correct the situation by imposing a federal system of charges on motor vehicle users. But that process would be circuitous, since the user revenues would have to be returned to the states in proportion to the amounts collected in each state. Any other basis of distribution—for example, that of some putative "need,"—would constitute a tax equalization program. User charges, based on services rendered, are clearly inappropriate for tax equalization purposes.

In all major respects satisfactory division of financial responsibility between state and local levels of government can be accomplished by proper road classification. In some cases, however, the administration of governmental services requires a standard of community service road development substantially in excess of that which the local community is willing to provide. The standards of road development required by current ideas of effective rural education serve to illustrate the point. Pupil transportation to consoli-

dated school units has characterized recent trends in rural education. This type of transportation must use all classes of roads and it imposes unusual demands on the relatively unimproved portions of the road plant. There appears to be no good reason why the incremental costs involved in improving segments of the road plant to the standards required for economical pupil transportation should not be charged against the educational budget. Land utilization programs fall into the same category.

Since this type of supplementary state interest does not justify absorption of the mileage involved into the general-purpose system, thereby shifting the entire cost to motor vehicle users, the only alternative is to induce local communities to improve these roads to the desired standard with general funds advanced by the state. Proper designation of the general-purpose system will of course minimize the necessity for such financial adjustments.

The third major determination that must be made in dealing with the distribution of highway cost concerns the extent and location of conflicts between publicly and privately managed transport enterprises.

Nature of Conflicts Between Public and Private Management: The nation's transportation service is provided partly under private management and partly under public ownership and management. This dual arrangement makes it impossible to achieve complete equalization of competitive opportunity among the differently managed transport media through the single device of sound highway policy, even though such policy be given universal application.

Prevailing tax policy creates the first type of continuing advantage for highway transport enterprises. The states levy no direct taxes on the value of physical properties devoted to highway purposes. Railroad corporations of course are taxed on the value of their physical properties. Because of this disparity in taxing practice those users of publicly managed highway facilities who are in direct competition with privately owned railroad enterprises enjoy some competitive advantage over such enterprises. This type of advantage is not removed by the allocation to motor vehicle users of the full actual cost incurred by the state in the provision of general-purpose road systems.

There appear to be formidable difficulties in the way of any effort to achieve equalization with respect to taxes on physical properties devoted to highway and railway use, respectively. If the adjustment were to be made by subjecting motor transportation to appropriate tax levies, two definite segregations would have to be made. First, highway operations which are directly competitive with railroad service would need to be segregated from the entire complex of road use. Such segregation would clearly be necessary, since many important uses of the rural road plant are in no way competitive with railroad service; the relationship between highways and rail-

roads is in major respects complementary rather than competitive. It would, therefore, be grossly inequitable to subject all road users to a compensatory tax merely because of the administrative difficulties involved in segregating the relatively small bulk of competitive services. Second, the portion of total road cost attributable to these specific competitive services would have to be segregated from other costs in order to secure an appropriate tax base. Moreover, these two segregations would have to be made for each state since the states have full proprietary control over the road function.

Consequently, if equalization of competitive opportunity is to be sought as an objective of national transportation policy, some method must be found to induce each state to adopt the desired taxing policy. Under present federal-state relationships, the federal government has no express power to compel state conformity with such a program.

If it should be deemed preferable to secure equality of tax treatment by exempting railroad trackage and right-of-way from state and local property taxation, the national government would still be faced with the problem of inducing the states to accept the desired tax policy.

The second continuing conflict between publicly managed highways and privately managed transportation facilities revolves around the question of capital costs. Considerable confusion has arisen with regard to the question of capital costs and their bearing on the so-called subsidy controversy. In this connection, it must be emphasized that no item or type of capital cost is escaped simply by virtue of the state management of highways. Under any circumstances, amortization and interest charges and maintenance and operating costs must be met. But the public agencies ordinarily are able to supply their capital requirements at rates that are somewhat lower than those available to private borrowers.

The lower cost of raising capital is due in part to the superior credit of a public body having power to tax, and in part to the fact that the securities of state and local governments have enjoyed a tax-exempt status. Consequently, the beneficiaries of state financed highway enterprises do enjoy some advantage over the managers of a privately owned railroad enterprise who normally must depend on the private money market for their capital requirements. This appears to be true for all practical purposes, even though public policy has sought to make railroad corporations akin to public agencies.

Where capital improvements are financed on a pay-as-you-go basis, that is, out of current tax collections, the highway system of course enjoys no advantage over the railroads.

If it is deemed wise public policy to remove or lessen the competitive advantage enjoyed by highway users over railroad enterprises, by virtue of the superior credit of the government and the special tax-exempt status of state and local securities, any one of

three methods might be adopted: (1) apply to government securities the same tax levies that are now imposed on the obligations of private enterprise; (2) extend to railroad securities the tax-exempt status now enjoyed by publicly operated enterprises; and (3) use the public credit to finance railroad rights-of-way.

Even though some means were discovered of equalizing the putative competitive advantage enjoyed by highway users by virtue of the tax and capital cost elements noted above, a third and perhaps the most important source of competitive advantage would remain, namely, that arising from the economies of joint use. Some of the traffic moving over the highways is competitive in character, while some of it is essentially non-competitive. For example, both commercial and long distance trucking and much long distance passenger car traffic might utilize the railroads, whereas for a large part of the local traffic and some of the longer distance traffic there is no practical alternative to the use of the highways. This essentially non-competitive traffic produces revenues the existence of which lessens the special charges which would otherwise have to be borne by those highway users who directly compete with the railroads. This joint use advantage from the standpoint of capital costs is of no small significance; in fact, the economies inherent in such joint use doubtless explain in large part the competitive advantages enjoyed by highway operators.

There are only two means of eliminating this type of competitive advantage. Both are essentially arbitrary in character. The first would be to require those highway users who compete with the railroads to pay the entire capital cost of general-purpose highways; the second would be for the regulatory agencies to establish on an arbitrary basis, an equality of competitive rates.

The adoption of the first of these expedients would clearly be inconsistent with the acceptable principles of highway financing, for such expedients would subject highway users to the types of inequities that those principles are designed to remove. Obviously, there would be no equity in requiring commercial operators to meet the full costs of general-purpose roads, while at the same time permitting their use by the general public. On the other hand, if special truck-and-bus-roads were built for and charged to truck and bus operators, solely for the purpose of bringing about road-rail equalization, the economies inherent in joint use would be sacrificed. It should be noted that the incidence of such sacrifice would fall on the general as well as the special highway user, for the substantial contributions now made by these truck and bus operators to the support of public roads would automatically be transferred to the specially provided commercial roads.

Under the second alternative, with rates arbitrarily equalized by a regulatory commission, competitive parity would obviously be established. But by the same token the advantages of competition

based on economic efficiency would be substantially destroyed. Competition would remain a determining factor only so far as the service feature is concerned.

The general plan of highway management outlined in this paper offers no formula by which the total costs of road provision may be neatly allocated between the general taxpayer and motor vehicle users. Such a determination in monetary terms can be made for the country as a whole only by aggregating the results of studies conducted in each of the states. And these studies cannot be made with any degree of accuracy until classification of the total road mileage according to predominating functional characteristics has been substituted in each state for the prevalent system of road classification based on historical and administrative factors.

The method of road management proposed here is based fundamentally on the conception of the entire road function as an essential activity of organized government—one that cannot appropriately be delegated to private enterprise. Full recognition is given to the fact that identifiable groups, land owners and occupiers, as well as motor vehicle users, derive specialized benefits over and above those which are distributed throughout society. Moreover, the system of management suggested recognizes that with regard to certain segments of the rural road plant, the special benefits bulk so large that the primary costs incurred in the provision of such facilities may appropriately be assigned by the state to special classes of users. It would appear that a system of management which makes proper allowance for these functional characteristics of the road will serve reasonably well to meet all of the requirements of equity in taxation, and will provide a sound basis for the eventual establishing of an equality of competitive opportunity among highway and railroad enterprises.

TWENTY-FIRST SESSION

THURSDAY, OCTOBER 16, 2:00 P. M.

Ballroom, Lowry Hotel

Philip Zoercher, presiding.

CHAIRMAN ZOERCHER: I don't see Senator Edmonds here. He wanted to know what the time was, and I gave him the time just before I left this morning. The hour has come for opening this meeting.

The subject for discussion this afternoon is "Possibilities of Federal Excises and Sales Taxes Especially as Related to Defense Program."

The first on the program is Robert Pettengill, Department of Economics of the University of California. His subject is "Classified versus Selected Sales Taxes to Finance Defense Program."

ROBERT PETTENGILL: Ladies and Gentlemen: There is one disadvantage in coming at the end of the program. The illustrious speakers who precede one at this particular point have covered most of the topics of interest; the others who might also fill the audience have got tired and gone home; some are sleeping off their after-dinner effects. I have been asked to talk about a topic which has not been widely discussed as yet, the topic of "Classified versus Selected Sales Taxes to Finance Defense Program."

CLASSIFIED VERSUS SELECTED SALES TAXES TO FINANCE THE DEFENSE PROGRAM

ROBERT B. PETTENGILL

University of Southern California

Whether we are now engaged in a "shooting war" or not, we are most certainly operating under a war-type economy. We are feverishly trying to produce billions of dollars' worth of military supplies partly in addition to, and partly in place of goods, for civilian consumption. The emphases in our philosophy of government are quite different, and the canons of taxation which we used as criteria in happier moments must now be revised and reconsidered.

Justice in the distribution of the tax burden is now less important than yield. We must increase federal revenue. Otherwise we shall

be hung on the horns of the dilemma of choosing between arbitrary price regimentation or a dangerous upward spiral of prices. However, it is axiomatic that a nation must not try to raise too much money by taxation for that might provoke a public revulsion detrimental to the military plans of its leaders. At present it seems better to reduce the citizen's standard of living by the less obvious method of bank borrowing and higher prices. Social expediency is certainly a "principle" of taxation which operates in time of war as well as in time of peace, though the possibility of using patriotic appeals to overcome anti-tax reactions must not be overlooked.

Another traditional canon of taxation states that the taxes selected should not discourage production and thereby curtail employment. In a war-type economy of the modern sort, however, a nation must reduce the production of certain goods in order to release materials and labor for use in industries considered more vital to the national military program. Much of the following discussion of alternative types of sales taxation will relate to this point. In so far as production for civilian use is deemed harmful to the nation's security, then one might apply the conventional criterion of social control to explain why some taxes seem preferable to others in financing the armament program. Minor criteria such as ease of administration, simplicity, convenience, etc., remain minor in the war-type economy.

SALES TAXES TO FINANCE THE DEFENSE PROGRAM

No one knows how much the defense program will cost the country, but we are sure it will be a tremendous sum. We also know that the tax bill which has recently passed Congress will not come within nine or ten billions of balancing the budget for this year, with bigger deficits ahead. Many of us are apprehensive about the mounting public debt, and prices are already rising with alarming rapidity, as the President has told us.

All of these signs spell larger tax bills to come. This particular round table has been instructed to examine the feasibility of various types of sales taxes in the current crisis. They can be made to yield large revenue promptly and are therefore quite likely to be used to reduce the prospective deficits. Other obvious advantages include their familiarity and semi-concealed incidence.

Even though we are not here to debate the relative merits of sales and income taxes in the present fiscal emergency, I cannot forbear to remark that many arguments against sales taxes which had considerable weight during the depression are no longer valid under expected conditions of full employment. Then we wanted to reduce hoarding; now we want to reduce consumer spending. The most direct road to the latter goal is taxation on the sale of the things which the great mass of low-income consumers ordinarily purchase. More severe personal income taxes, especially if collected at the

source with suitable exemptions, would be preferable, but seem politically more difficult to enact.

Assuming that additional sales taxation is in the offing, what kind should we advocate? I have been asked to discuss the relative merits of selected versus classified sales taxes. In the federal revenue budget, transactions in selected commodities have long been taxed by excises and import duties. States have more frequently used classified sales taxes which impose ad valorem rates upon a whole group of commodities, as upon goods sold at retail. These rates have occasionally varied according to the class of commodity, such as low rates upon necessities and high rates on luxuries. Which type of sales tax should the federal government now use? Should it select additional commodities for specific taxation and raise the rates on those already taxed? Or should it enact a general retail sales tax, or a manufacturers' sales tax, or a tax on all transactions? And if several types are used, how may the system as a whole be made most equitable and socially beneficial?

The answers to these questions must be given in reference to the peculiar needs of a nation arming to the teeth. There is not nearly enough aluminum, nickel, tungsten, copper, and other materials to supply both military and civilian needs. Normal consumption must be curtailed. This can be done in several ways: (1) By priorities and rationing which reduce supplies going to producers of consumption goods; (2) by voluntary or mandatory restrictions of output, such as that planned by the automobile industry for 1942 models; (3) by price increases which restrict consumer demand. All three of these methods have already been introduced in one connection or another, and they are somewhat interrelated. If producers of durable consumption goods cannot get raw materials in as large quantities as before, they must curtail output individually or in concert with other firms in the same industry.

The traditional way of apportioning scarce goods among alternative users under the capitalistic system is the use of the price mechanism in the free market. We let competitive demand raise prices until a figure is reached at which the quantity demanded equals the quantity supplied. If we follow this pattern in the present juncture, prices will probably rise far above unit costs of production, since many consumers derive their incomes from "defense industries" which do not contribute offsetting supplies of consumers' goods. Abnormal profits for producers and middlemen would be the result in many cases, although we must recognize that in some instances a reduced volume of output will raise unit costs considerably.

The logical method of dealing with this situation would seem to be selected sales taxes at high rates on such durable consumption goods as automobiles, radios, washing machines, refrigerators, etc. Such taxes would do four desirable things at one time: (1) Raise needed revenue, (2) cause retail prices to rise, (3) prevent ab-

normal profits, and (4) curtail the demand for goods using essential raw materials. The price and profit aspects of rationing are somewhat analogous to the quota method of restricting imports. Quotas raise domestic prices to the great benefit of domestic sellers provided only that the government does not at the same time impose an import duty to absorb this profit for itself.

This sort of sales tax program would also avoid other developments which most good Americans would view with alarm. Supposing the government decides that it wishes to impose price ceilings on consumer goods of this type as it has already tried to do in certain lines, such as automobile tires. The motive is a double one, to prevent profiteering and to keep down the cost of living, but it must inevitably lead to some type of arbitrary rationing of limited supplies among clamoring consumers. Is the automobile dealer this winter going to have the power to make arbitrary decisions as to which of his potential customers shall get cars and which must go without? Are we going to see indirect forms of bribery and personal favoritism replace the free market in the distribution of goods at retail?

I hope not, but I see no other outcome unless the government adopts another bad alternative, that of trying to ration consumer purchases from above. The ration card plan has merits when applied to necessities of frequent purchase and consumption, such as foodstuffs. But it is more difficult with clothing, and the difficulties become staggering when applied to the long-life durable consumption goods of the semi-luxury type which we have been considering. In short, if this is a war to make the world safe for democracy and free enterprise, we must adopt fiscal expedients which retain during hostilities as much as possible of those institutions we cherish. Selected sales taxes seem better adapted to this purpose than arbitrary rationing by government or merchant.

THE CLASSIFIED SALES TAX AS A FEDERAL REVENUE DEVICE

One big difficulty with selected sales taxes is the opposition which they encounter from vested interests when proposed in Congress. Classified sales taxes are politically more expedient, especially if the classification is very broad, as on all retail sales except foodstuffs. But the minute the legislators try to distinguish between necessities and luxuries to impose different rates, the same political difficulties emerge which are encountered in passing specific excises. Furthermore, classified sales taxes have only two important merits: they raise revenue and they reduce consumer buying. Their imposition would leave unsolved the problem of allocating among consumers the scarce durable consumption goods. And revision of our income tax laws could accomplish the two major achievements of the classified sales tax with greater equity.

There are also serious problems of double taxation which would arise from a federal sales tax. Existing federal excises would presumably not be repealed and there would be a doubling up in those instances. More important would be the invasion by the federal government of a tax field heretofore chiefly the province of the several states (and a few municipalities). Granted that there is already much overlapping in our uncoördinated tax system, that is no reason for making it worse.

Another argument against a federal classified sales tax in the present emergency is that it would be harder to shake off in the post-war period of fiscal reconstruction than would the selected sales taxes which we have advocated. This is a political rather than an economic judgment, but I believe it is sound. For many years the payers of large income taxes have tried to get relief from their burden by means of a federal sales tax which economists have agreed would be regressive and inequitable. Once fastened upon us by a war emergency, such a tax would be difficult to repeal because institutional inertia would then reinforce active propaganda from selfish interests. On the other hand, selective sales taxes on durable consumption goods would tend to make the tax system as a whole more progressive, and at the close of hostilities there would be strong vested interests pushing for their repeal.

SELECTED SALES TAXES AND THE PROBLEM OF ADEQUATE REVENUE

I have not been able to make any estimate of the probable yield of sales taxes upon durable consumer goods, but I recognize that they would not yield very much in relation to present fiscal needs. The primary argument in their favor is "social control" in support of the armament program and traditional institutions. Therefore they should be used even though they are supplemented for yield purposes by other sales taxes or additional income taxation.

One of these possibilities is higher rates upon the commodities which now yield most of the federal excise tax revenue, namely liquor, tobacco, and gasoline. I understand that subsequent speakers will consider some of these taxes in detail, and I pause here merely to suggest the regressive nature of all three taxes. As a social control device the liquor taxes have compensating merits, and I would like to see them markedly increased even to the point of diminishing total revenue. Rather than increase taxes on the other two items, however, and place additional taxes on conventional necessaries such as electric power, I would prefer to raise needed revenue by additional personal income and inheritance taxation as already suggested. Incidentally, gasoline taxes might aid somewhat in conserving defense resources.

We could also raise rates on luxury items and extend the list back to its pre-1938 scope or beyond. This would bring in additional

revenue and satisfy criteria of equity more than would a general manufacturers sales tax. In so far as the resulting higher prices of these articles and services led to reduced consumption thereof, that would also be good, for it would release workers for employment in defense industries. A recent estimate puts the number of workers that will be needed for the full-out armament program planned for 1944 at the staggering total of 23,500,000, or more than 40 percent of the working population.

These employees must come largely from industries now producing for civilian consumption. A comprehensive schedule of luxury taxes at severe rates would help to facilitate the transfer of workers from less essential to more essential employments. Though it would mean hardships for the temporarily displaced laborers, it might postpone for a few months the necessity of introducing the labor conscription, freezing, and allocation procedures which seem to be an inevitable development of a modern war-type economy judging from the experience of both Britain and Germany.

A NEW FORM OF SALES TAX: PROFESSOR FISHER'S SPENDINGS TAX

In lieu of either of the two traditional types of sales taxes herein evaluated, a word might be said in favor of a tax on spendings such as that advocated by Professor Irving Fisher. This would be the equivalent of a sales tax, but it would be collected from individual income recipients. The tax base would be calculated by subtracting from gross receipts all business expense, investments, taxes paid, and net change in cash balance. This would give the approximate amount spent for consumption goods during the year without requiring records to be kept of separate spendings as they occur. Further deductions for dependents and minimum exemptions as under the present income tax law would also be allowed. The final tax base differs from the existing income tax base chiefly in that investments are subtracted from gross receipts in order to render that type of disbursement free from taxation. Professor Fisher believes this is essential to the preservation of a dynamic economy under the system of free enterprise. In his complete program for tax reform he would compensate for this removal of hindrances to capital accumulation by imposing much higher estate taxes.

The chief advantages of a spendings tax of this type are: (1) By using a schedule of rates which rise with successive increments to the tax base (amount of spending) it could be made clearly progressive and would be a deterrent to expenditures on luxuries while stimulating much needed investment; (2) it would require no cumbersome new machinery for its collection; (3) it could be used to supplement other forms of taxation such as the regular income tax and the resource-diverting selected sales taxes advocated above. Like the traditional income tax it suffers from the disadvantages of being both slow to yield revenue, and relatively impotent to check

inflationary spending in the year when the income is received and spent. In the present emergency it would seem to fit best into a revenue program which used monthly income tax collections at the source supplemented by an annual review and readjustment of tax obligations on the basis of consumption spendings instead of income calculations of the type now required.

CHAIRMAN ZOERCHER: We thank you. Your paper was limited within the proper time.

The next on the program is Miss Mabel L. Walker, Director of the Tax Institute. Her subject is "Excises and Sales Taxes from Standpoint of Revenue."

REVENUE POSSIBILITIES OF FEDERAL EXCISES AND GENERAL SALES TAXES

MABEL L. WALKER
Director, Tax Institute

The revenue potentialities of general sales taxes and selective excises in a defense program can be considered only in broad outlines because of the infinite number of variations possible in adopting such levies.

We might set up a number of hypothetical taxes and attempt to estimate the possible yields from them. But in making such estimates we should also have to indulge in a number of hypotheses concerning business conditions, consumer resistance, and other factors entering into the picture. The estimates that would emerge from this labyrinth of hypothetical calculations would still be only estimates and subject to a very large margin of error.

I prefer to make another approach to the problem by examining the revenue history of recent years to see what the past offers as a guide.

The Tax Institute is this week releasing its new compilation, *Tax Yields: 1940*, which gives a detailed record of federal tax collections for the last thirty years and a detailed record of state tax collections for the last ten years.

The federal government has never experimented with a general sales tax. Approximately half of the states, however, do utilize this tax, usually in the form of a tax on retail sales. Collections from these state taxes amounted to almost half a billion dollars in 1940. It is difficult to translate these figures into anything resembling an estimate for a federal sales tax for several reasons. For one thing a federal sales tax would probably take the form of a manufacturers' levy instead of a tax on retail sales. For another thing a tremendous wave of buying has taken place since 1940 and bids fair to increase in the near future. This would naturally result in very much increased revenues.

For these reasons I shall merely point out that the indications are that a federal sales tax would be enormously productive, without attempting to be more specific. It is doubtful, however, that it could be made as productive as existing federal excises, unless levied at a very high rate.

We have much more to go on in connection with federal excises. Selective sales taxes, or excises, have played an important fiscal rôle in our American tax system. Lawmakers rely on them heavily during periods of war and depression, but tend to relieve the pressure on this source of revenue during periods of prosperity.

Perhaps I should stop at this point to attempt a definition of excises. One hears a great deal these days about excises. Persons in the tax field use the term glibly, but none too precisely. As a matter of fact, the term has no generally understood precise meaning. Historically, the distinguishing features of the excise appear to be that it is a tax on consumption and that it is an internal levy. Popularly, it is a consumption tax rather than an income tax. But legally, the point of distinction is that it is not a property tax, and income taxes have been upheld as excises because they are not property taxes. In this talk the term will be used to refer to selective sales and transactions taxes. Such levies are frequently also termed nuisance taxes.

CATEGORIES OF EXCISES

Our federal excises may be divided into three main categories, classified according to purpose. First are those excises of a restrictive or prohibitory character. These are permanent features of the revenue system. They yield little revenue and are not levied with the purpose of being productive. Adulterated products, narcotics, oleomargarine and vegetable oils (which may compete with dairy products) are in this category. The first three taxes have been in effect several decades. These taxes have shown little variation in yield over the three decades. The tax on coconut and other vegetable oils which was imposed in 1934, is the most productive of the four levies.

The second category of excises consists of those imposed primarily for revenue. An incidental repressive effect, however, if not actually intended, is at least not considered objectionable. Alcoholic beverages, playing cards, and tobacco are in this category. The consumption of these commodities is considered by many persons to be physically or morally injurious. Hence, if the taxes reduce consumption, so much the better. The fear of bootlegging constitutes the main limit to the amount of tax imposed on such commodities. The yield from these taxes shows a steady long-term rise. This was, however, interrupted during the period of prohibition.

The third class of excises, in contrast to the other two, is usually imposed during an emergency, rather than as a permanent feature

of the revenue system, and is imposed for revenue, rather than regulatory purposes. It consists of levies on what are considered luxuries or semi-luxuries. A large number of items have been included in this category. Since these taxes are imposed in times of emergency and the rates and coverage of the taxes are increased as the emergency deepens and decreased as the emergency eases, it necessarily follows that over a period of years they show sharp fluctuations in yield. Such levies reached their peak in 1920, substantially exceeding the yield from the preceding category of excises. The yield therefrom dwindled to an inconsiderable amount in 1932 but rose sharply thereafter as the nuisance taxes of 1932 began to make themselves felt. The trend has not been sharply up or down for the last several years as the effect of improved business conditions on the yield has been offset by repeal of a number of the excises. It seems fairly safe to predict, however, that the next year or so will show a sharp increase in productivity due on the one hand to greatly increased use of these excises in financing defense, and, on the other, to improved business conditions. It is probable that they may again exceed the second category of excises just as they did in 1920.

Income, profits, general sales, and selective sales taxes are the four great revenue possibilities in time of war. During the first World War and to date in the present emergency, there has been no general sales tax but there has been heavy reliance on the other three methods of taxation.

The excises of 1918 are of particular interest at this time as a forecast of what may be to come. Generally speaking, the levies seem to have been imposed on what were considered luxuries or semi-luxuries. Food, fuel, furniture, and moderate-priced wearing apparel were not taxed. Coffee, tea, sugar and salt, which have so often borne the brunt of emergency taxation in various countries were untouched.

The prohibitive excises are fiscally unimportant and need not concern us here. The other two classes of excises offer enormous revenue potentialities. Fear of bootlegging may prevent any very great increase of the taxes on alcoholic beverages and tobacco which have already been heavily tapped. It is to the third class of excises that we must look for most of the additional excise revenues.

It is theoretically possible to specify any item of consumption, whether of goods or services, as a selected tax-bearer. A vast number of items were so specified in the Revenue Act of 1918, and a fairly considerable number of items were listed for taxation in the depression years of the early thirties.

THE MOST PRODUCTIVE EXCISES

During the last three decades six of these selective excises have reached the productivity point of $100,000,000 in one year. These

taxes listed in the order of maximum productivity are taxes on alcoholic beverages, tobacco, transportation and transmission, gasoline, autos and auto parts, and admissions and dues.

These taxes are the big six among the excise revenue producers. They accounted for 77 per cent of the total yield from excises in 1920 when excises reached their post-war peak, and for 93 per cent in 1940 when collections from excises touched an all-time high.

The next most important revenue producers among the selective sales tax group are stock transfer and document registry taxes, which yielded $81,259,000 in 1920; soft drink taxes which yielded $58,676,000 in 1921; tax on sales of electrical energy which yielded $42,339,000 in 1940; and a tax on checks which yielded $41,383,000 in 1934.

Tax	Amount	Year of Maximum Productivity
Alcoholic beverages	$624,253,000	1940
Tobacco	608,518,000	1940
Transportation and transmission	303,289,000	1921
Gasoline	257,420,000	1940
Autos and auto parts	158,015,000	1924
Admissions and dues	100,002,000	1921
	Over $50,000,000	
Stock transfer and document registry	$81,259,000	1920
Soft drinks	58,676,000	1921
	Over $40,000,000	
Electrical energy	$42,339,000	1940
Checks	41,383,000	1934

If we add these four to the six previously mentioned we find that these ten most productive excises accounted for 96 per cent of total excise yields in 1920 and 97 per cent in 1940. These ten excises yielded 21 per cent of total federal tax collections in 1920 and 36 per cent in 1940.

Even though the excise yield is enormously increased in the next year or so it is likely that its relative productivity will be greatly diminished because of the enormous increases anticipated in the yield from income taxes.

Other excises such as those on candy, chewing-gum, jewelry, cosmetics, radios, mechanical refrigerators, furs, and numerous other items have proved less productive, accounting altogether for only 3 or 4 per cent of the total excise yield either in 1920 or 1940.

This paper is concerned only with the revenue possibilities of these taxes. Their economic and social effects and the relative desirability of the various excises, or of selective excises in contrast to general sales taxes, will be discussed by other speakers.

There are two great factors affecting the productivity of any tax—the terms of the law itself setting forth rates, exemptions, etc., and general business conditions. The increased prosperity and the increased consumer buying which appear to be prevalent will greatly increase the productivity of existing levies. Furthermore, new excises and rate increases are now going into effect. Indications are that new records of productivity will be established in 1942.

On the basis of past experience it appears that during the present emergency we may look for the most substantial increases in excise revenues from minor items of widespread use, such as admissions, candy, chewing-gum, soft drinks, and cosmetics; from relatively expensive but much less widely consumed items such as automobiles, radios, and refrigerators; and from services, such as transportation and transmission, electrical energy, and insurance.

Chairman Zoercher: Thank you, Miss Walker.

I have been requested to let one member on the program come a little in advance of his time. I don't know whether he has to make a car or is going to fly, but he said he had to leave at an early time, so instead of calling on the next one on the program, Mr. Craig, I will call on H. Clyde Reeves, the Commissioner of Revenue of the State of Kentucky, on the "Effects of Specific Excises on Various Commodities." Mr. Reeves will talk on tobacco. Mr. Reeves.

ADDITIONAL FEDERAL EXCISES ON TOBACCO AND THE DEFENSE PROGRAM

H. CLYDE REEVES

Kentucky Commissioner of Revenue

Sir Walter Raleigh, who may have introduced the smoking of tobacco to the English speaking people, could not have guessed the important part which it would play in the civilization of man and the support of twentieth century governments. Indeed from the beginning it has played an important part in the development of America. In colonial Virginia it was used as a medium of exchange. Wives were purchased and taxes were paid with it.

The federal government began taxing tobacco in 1862 with a levy on cigars. In 1863 federal taxes on cigars, chewing, smoking tobacco and snuff amounted to nearly $3,100,000. In '64 a federal tax was imposed on cigarettes. It was not until 1921 that Iowa enacted the first state cigarette tax. Since that time the number of states taxing tobacco products has steadily increased. Now twenty-eight

tax cigarettes, and a somewhat lesser number tax the other products. The federal tax is imposed upon the manufacturers of all taxed tobacco products. They are required to operate bonded factories, and the tax is therefore, as conceded by everyone, collected without any evasion on all such products manufactured and sold in the United States.

The federal tax is at present $3.25 a thousand on small cigarettes, or 6½ cents a package of twenty. The tax on cigars is 75 cents a thousand on the small cigarette size cigar, and ranges from $2.00 a thousand to $13.50 a thousand on cigars weighing more than three pounds per thousand, graduated according to the retail price. Chewing tobacco and snuff are taxed by the federal government at 18 cents a pound, and cigarette papers are subject to a tax of one-half cent for fifty papers.

On the basis of a package of cigarettes a day, which in the trade is generally considered to be a fair average of consumption by an individual smoker, each smoker pays an annual tax to the federal government of $23.73. The daily smoker of half a dozen 10 cent cigars would pay annually $10.95, and the user of tobacco in other forms would probably pay less federal tax.

There are two general classes of factory made cigarettes in the United States: (1) the so-called 15 cent cigarettes, and (2) the so-called 10 cent cigarettes. The manufacturer's selling prices after trade discounts and excluding the federal tax, average about 5.0 cents a package, and 2.4 cents a package, respectively. Federal tax in the case of the so-called 15 cent cigarettes represents a tax of 130 percent of this selling price, and in the case of the so-called 10 cent cigarettes it is a manufacturer's tax of 271 percent. On the basis of the consumer's price, excluding state taxes, 43 percent of the retail selling price of a 15 cent package is federal tax; and 65 percent is federal tax in the case of cigarettes retailing at 10 cents. The tax on cigars amounts to about 5 percent of the retail selling price, and the tax on other tobacco products is somewhat proportional.

In the case of cigarettes the tax far exceeds the amount derived from their production by the farmer, manufacturer or jobber. As a whole, the government is probably the greatest beneficiary of the tobacco industry. The tax has been justified as a luxury excise, and has been imposed more heavily upon cigarettes than other tobacco products, probably for sumptuary and administrative reasons.

CRITERIA OF A GOOD DEFENSE TAX

We hear much at this time of designing a tax system to finance the defense program which will have the desirable effect upon a war-type economy of reducing civilian consumption and restricting purchasing power so as to impede inflationary tendencies. To the extent that taxes have such an effect their reliability as revenue pro-

ducers declines. The consumption of cigarettes has doubled since 1928, which is about the time cigarette smoking by women became accepted. With the exception of the depression years of 1932 and 1933, when there was some decline in consumption, the increase has been steady. Since 1932 the consumption of cigarettes in the United States has increased more than 450,000,000 packages a year. During this same period fifteen states imposed cigarette taxes, the levy varying from 1 to 5 cents a package, with an average state tax of about 3 cents. Since addition of the half-cent tax on a package of twenty cigarettes by the federal government, effective July 1, 1940, the output of cigarettes has increased markedly. The consumption of other tobacco products has increased much more slowly. Statistical evidence supports the fact, to which any habitual user will testify, i. e., that the demand for tobacco is relatively inelastic. Consumption as between the types of tobacco is affected somewhat by the price and the availability of purchasing power. This is particularly true between smoking tobacco and cigarettes, as was demonstrated by a decline in the per capita consumption of cigarettes in 1931, with an increase in that of smoking tobacco for the same year, whereas by 1935 the trend of the two products was reversed.

It is believed that during a period of maximum employment and psychological tension as may reasonably be anticipated for the next few years, there will be a tendency to accelerate the increase of the consumption of tobacco products, particularly cigarettes. Experience in Great Britain indicates that the consumption of tobacco may have been stimulated considerably by the war efforts and terror. Although the acceleration of the increase may be retarded by taxation, it would certainly take very heavy additional levies to curtail consumption. These things all point to the conclusion that the demand for tobacco will increase, and that an additional tax on all tobacco products would be a reliable revenue producer. A tax on tobacco would tend to implement a policy of restricting purchasing power, particularly among wage earners because it is regressive; however, the increase of a few cents a day to the consumer would have but small effect upon the total demand for consumer goods. Since, excepting electric energy and manpower, the factors for producing tobacco products are not particularly vital to defense production, the desirability of curtailing consumption is mitigated. When the effect upon the civilian morale of the failure to satisfy the desire for tobacco is considered, curtailment of consumption may become actually undesirable.

It is appropriate to consider in normal or abnormal times the incidence of any proposed tax. Determination of incidence is extremely difficult, and no conclusive findings on this point are purported to be presented here. Investigation of consumption trends, manufacturers' and jobbers' profits, price to the consumer, and the amount received by the farmer for tobacco, and the statement of

manufacturers and jobbers of cigarettes support the thesis that consumption taxes are usually passed on to the consumer. The last increase of one-half cent a package in the federal tax appears to have been passed on to the consumer, except in chain stores which absorbed it, and independents who because of competition were forced to assume the burden. The manufacturers may have assumed some of the tax in placing king size brands on the market. Manufacturers, jobbers and retailers have in some instances shared the burden where passing it on would have increased the state tax, as in the case of Kentucky which levies a cigarette tax of one cent on each 10 cents or fraction thereof of the retail selling price. It is believed, however, that if purchasing power in the hands of smokers increases faster than retail prices generally, an increase in tax, unless it was very small, would be passed on to the consumer. If the tax is passed on to the consumer there will be a tendency, as has been demonstrated in the case of cigarettes when state taxes have been imposed, for the consumer to use other tobacco. If, for example, a relatively high additional tax was imposed on cigarettes, but the tax on other tobacco products remained the same as at present, undoubtedly some consumption would be diverted to handmade cigarettes and pipe tobaccos. This strongly suggests that if the tax is raised on cigarettes a comparable levy should be imposed on the competing products, else the cigarette tax yield may be disappointing and the competitive disadvantages may give rise to economic changes for which there is no apparent justification.

OBJECTIONS TO A TOBACCO TAX FOR DEFENSE

1. Since the tax on tobacco, particularly cigarettes, is already very high, efforts to impose additional tax will be countered with the argument that a tax of one-half cent a package has already been imposed for defense and that the selling price of the product is now half tax. Since the imposition of the manufacturer's tax on tobacco products is not easily evaded, and there is not likely to develop a pronounced tendency to use unprocessed tobacco, this objection probably has but little validity.

2. Such a tax will be imposed only upon cigarettes as was the case of the last federal tax increase and as has been the practice in many states. The effect upon consumption from a tax on cigarettes alone have been discussed, and the objection to a tax on cigarettes without a correspondingly burdensome levy on other products appears valid.

3. A tax on tobacco products is regressive. The poor man uses as much tobacco as the wealthy one. The soundness of this objection cannot be disputed.

4. Traditionally the federal tax on cigarettes is a specific one. A flat increase in the tax on cigarettes will decrease the relative difference in the selling prices of the so-called 10 and 15 cent brands,

and will encourage the use of smoking tobacco at the expense of cigarettes. A leading tobacco company has compiled statistics to show that a flat tax when imposed by states has this effect, while in Kentucky, which has an ad valorem tax of one cent on each 10 cents or fraction thereof of the retail selling price, the consumption of cigarettes does not appear to have been curtailed by the increased use of other tobaccos.

5. The tax on tobacco will hurt the farmer in that he will receive less for the crop produced. Though there is no proof of this, the political power of the argument may be appealing to Congress, particularly in the face of the fact that it has appropriated large sums for payments to tobacco farmers. The fact that prices for most kinds of tobacco now equal or exceed parity payments should be an offsetting argument. During recent years the production of most types of tobacco has exceeded disappearance and there are large reserves on hand. As complete employment is approached, however, it appears that an adequate supply of labor to produce the usual crops may be lacking. It is recalled that this happened during World War I. In such an exigency it is predicted that the price received by the farmer for tobacco will increase substantially because maintaining continuity is important to the manufacturer. Cigarettes particularly are made by blending tobaccos of several years, and the failure of the manufacturer to secure an adequate supply of any crop might result in a change in the flavor of the product which has been established at great cost. For this reason it is believed that a scarcity of tobacco may cause prices paid the farmer to increase more than the increase in the cost of crop production.

6. If a tax is added to tobacco for defense purposes it will never be removed. Such a possibility cannot be denied.

7. Further tax increase on cigarettes would make it impossible to sell them at the customary prices. The fact that profits of the major cigarette manufacturing companies from 1935 through 1940 consistently ran from about 9 to 11 percent of gross income indicates that a proposal that manufacturers could absorb some tax increase merits consideration.

8. An increase in cigarette taxes would increase the retail price and automatically increase state taxes in Kentucky and South Carolina which impose a levy graduated by the retail price. This would be true in the case of the so-called 10 cent brands in Kentucky. (No study of the problem in South Carolina has been made.)

9. A tax on tobacco has no particular merit of social control such as curtailment of civilian consumption which is deemed to be desirable in a war-type economy.

10. Federal tobacco taxes produced only $698,077,000 in 1940-41 which is ninety million over the previous fiscal year. It is estimated that approximately half this amount was due to the half cent per package federal tax effective July 1, 1940. Therefore a reasonable

tax increase would in the light of federal needs produce only a nominal amount of revenue.

ADVANTAGES OF A TOBACCO TAX FOR DEFENSE

1. The relatively inflexible demand for tobacco products guarantees a reliable yield from the tax.
2. A tax on tobacco products will yield revenue quickly. It is paid by the manufacturer substantially as the tobacco is processed and the government would not have to borrow in anticipation of tax receipts as in the case of income, inheritance and other levies suggested for defense purposes.
3. Because the tax is collected from the manufacturer of tobacco products it is easy and simple to administer. The absence of illegal manufacture and bootlegging makes the enforcement costs low.
4. The tax fits into the traditional canons of taxation in that it does not discourage production.

CONCLUSIONS

In conclusion it is submitted that the possibilities for avoiding additional excises on tobacco initiated for defense purposes are not bright, and if such taxes are levied so as not to encourage the use of one product at the expense of another those interested in tobacco as producer, manufacturer, jobber and consumer probably have no sound objections to such a tax as a temporary and emergency measure in the light of a realistic concept of what a ten billion deficit this year, and a larger one facing us for next year, mean. It is recommended, however, that any consideration of an increase in the federal tax on cigarettes involves study of the possibility of making the increase ad valorem in nature. This would tend to maintain the existing equilibrium between cigarettes on the one side and smoking tobacco on the other; would rid the tax of some of its regressive characteristics; and is in keeping with the policy adopted by the federal government in its levy upon cigars, and in accordance with that of two states.

CHAIRMAN ZOERCHER: Next we call on Mr. Craig, president of the American Retail Federation, of Washington, D. C., whose subject is, "Excise Taxes to Control Consumption."

EXCISE TAXES TO CONTROL CONSUMPTION

DAVID R. CRAIG
President, American Retail Federation
Washington, D. C.

These remarks must start from the viewpoint of the retail merchant rather than from any special knowledge of taxation. Retailing is primarily a peace-time industry; its success depends upon the

rapid flow of goods from producer to consumer. Retailing depends on democracy and freedom for its prosperity. In its stores the public is free to vote for what it wants to be produced, and free to withhold its vote from any item which it does not want. In normal times, it would be completely ridiculous to ask a representative of retail merchants to discuss the control of consumption.

Now it appears that if the democratic tradition is to survive, it must be put on the shelf for a little while. We cannot have the free flow of goods from producer to consumer because some of the goods (or the manufacturing or labor capacity which makes them) are needed for the military effort. Civilians must tighten their belts. If there are not enough goods to go around, obviously the usual plan of permitting production to follow free civilian demand must be abandoned. Freedom of choice disappears in these circumstances. From the political viewpoint, the main consideration is not to put the democratic tradition on such a high shelf that it is no longer possible for the public to reach it, and take it down again when the emergency has passed.

The emergency situation is aggravated by the question of price. While the defense program has been growing, employment has substantially increased, and wages have been going up. Since June of 1939, non-agricultural employment has risen 14.2 percent. Wages by the week have risen 29.1 percent. Freedom of choice must disappear just at the moment when large groups of the population, for the first time in almost a decade, are able to make any choice at all. Their demand has already turned the situation into a seller's market. Now the goods they want must be restricted, and the foundation has been laid for a price spiral of significant proportions.

Retail merchants want no such price spiral. They are accused of profiteering while prices are rising, even though they are barely meeting their increased costs; and when the spiral comes, as it always does, to a sudden end, their profits vanish.

That is why they look to any orderly method of preventing a price spiral. Excise taxation may be one such method. They have always been suspicious of excise taxation during peace-times, for they have always felt that it might hurt their business. But now, with the defense program staring them in the face, they find other developments which may hurt their business even more.

Like any other tax, the excise tax has a primary effect in raising revenue and a secondary effect which depends upon its character. Miss Walker will have preceded this paper with a discussion of revenue from excise and sales taxes. We will discuss here only the secondary effect. This discussion can assume that it is now, or presently will be, necessary to restrict civilian consumption, and it can raise and discuss two principal questions: (1) The consumption of what items is to be restricted? (2) At what level should the tax be imposed?

It would be a mistake to attack these questions without first examining briefly other ways of controlling consumption.

First comes rationing. This method can be used for particular items in short supply. As Professor Pettengill points out, this may be an undemocratic and often arbitrary method. Moreover, it requires a complicated administrative machinery. But it must not be overlooked as a useful device in the event of price controls, for price control without some formal rationing plan is sure to result in black markets and evasion.

Second, as a method of controlling consumption, is the regulation of installment credit. This method has already been applied to a number of items whose production is in competition with the national defense program, and to one item—furniture—which is not. A substantial portion of consumer's durable goods are purchased on installment credit, and as the Federal Reserve Board restricts credit, the demand for those goods is expected to decline. The strange appearance of furniture in the list of controlled items can be discussed later.

Third is the lowering of the income tax exemptions. The consumption of the lower-income groups cannot help being restricted by the amount of any tax.

Fourth is the proposal for increased payroll taxes, possibly on the Keynes plan, settting aside income now and making it available later as a necessary stimulus to the revival of civilian production after the war.

There may be other proposals to restrict consumption, but these are the principal ones. Let us assume without argument that the best of these methods is the excise tax, so that we can turn to the first question.

The first question is: What items are to be restricted as to their consumption?

Obviously, consumption must be restricted for items which are essential to the defense program. There is an acute shortage of copper, for instance, and it is much needed for defense. In such an item, the civilian consumption of copper must be reduced. The same shortage exists, although in some cases in less degree, in aluminum, zinc, steel, and in general among the metals (except silver and gold). Items made of metal, like refrigerators and many other household appliances, must be yielded by civilians to the defense program. Their production, in many cases, has already been curtailed. If the government is to avoid competition with a greatly increased civilian demand for these items without creating windfall profits for producers or distributors, it is important to reduce the civilian appetite by means of an excise tax. The effect of the tax is to increase the civilian price, and the government gets the increase.

It is equally obvious that except to raise revenue, no excise tax, nor any other method of restricting consumption, should be applied to goods which are not in competition with the defense program. Take furniture, for instance. There is apparently an ample supply of wood and manufacturing capacity and labor in furniture not now needed for producing the currently estimated defense needs. No excise tax need apply.

It is necessary, however, to distinguish between the possible effects of selective excise taxes and a general excise tax. A relatively small selective excise tax is useful only in raising revenue. As a general rule, it will not have the effect of controlling consumption. Even the rate of the cigarette tax (which would be regarded as terrific if it were applied to refrigerators) has not limited cigarette smoking by the public. To limit the consumption of a given item, a tax must really hurt those who are asked to pay it. Otherwise they are likely to continue in their purchases of the item in question, and get even with the system by reducing their purchases of other items. For example, taxes on gasoline or liquor or cigarettes may have an effect in reducing the average price paid for a suit of clothes, or the number of moving picture tickets purchased, or in lengthening the interval between haircuts.

To avoid misunderstanding, I should add that this need not be misconstrued as an argument in favor of a general excise tax. That is a different question, which concerns primarily the raising of revenue, and we are limited here to a consideration of restricting consumption.

Another issue which does not concern us except incidentally is the luxury tax. A luxury can be defined as something which somebody else thinks we ought not to want. Presumably the new retail excise taxes on furs, jewelry, and toilet preparations, were regarded by their proponents as falling in this category. It is too early to know the extent to which of these 10 percent taxes will limit consumption. At the moment we know only that sales of these items during the two weeks prior to the effective date of the tax were extraordinarily good, which is a sign that many people regard these items as necessities rather than luxuries, and were trying to avoid the tax. They were enacted as revenue producers rather than as methods of limiting consumption. None of these items is in competition with defense. None of these taxes was intended to promote defense. In general, these were revenue taxes.

From the viewpoint of restricting consumption there is an additional question which interests the retail merchant. Should the tax be imposed at the manufacturing level or the retail level?

If the tax is imposed on the manufacturing level, it becomes an additional item in the retailer's cost. Traditionally his mark-up has depended on the amount he has had to pay for goods, and if the

price which he had to pay increased, he merely added his mark-up and established the retail price at a new level. Recently Leon Henderson, price administrator, asked retail merchants not to take any mark-up on new manufacturing excise taxes or on new increases in existing manufacturer's excise taxes. Retailers everywhere were disturbed by this request, for it not only required a large amount of clerical differentiation between their pricing policies on different items, but more than that it implied that unless they acceded to the request they would be unpatriotic. In general, they have decided to comply with the request, on the ground that compliance is good public relations, even though it costs them a part of their net profit on the items in question. The question is important here only because it raises an entirely different issue about the control of consumption.

If the purpose of the new manufacturing excise taxes was to restrict consumption, the restriction would have been somewhat greater if Mr. Henderson had not made his request. If consumption is to be controlled by raising prices, and if prices are to be raised by excise taxes, they would have been rasied higher if the ordinary retail-mark-up were applied. But many of these new manufacturing excise taxes were imposed more for the sake of revenue than for the sake of restricting consumption.

Before we reach a conclusion we can return briefly to the general excise tax either at the manufacturing level or at the retail consumer level.

I pointed out that a relatively small excise tax may not succeed in restricting consumption of the item taxed. Instead, it may have the effect of restricting the consumption of other items. To the extent that this is true, we are led to the conclusion that if it is desirable to restrict consumption generally, the restriction can be obtained by imposing a general excise tax or sales tax (or by one of the other four methods listed).

We do not feel, however, that there should be any necessity of restricting consumption on all items alike, for many of them are available in adequate quantities, including many which are commonly regarded as necessities. For example, there is plenty food, and it is customary to temper the severity of general excise tax proposals by exempting food. Instead, we need a selective restriction.

Thus, we come to our principal conclusion. It is that when consumption is to be restricted by excise taxation, it can be accomplished by a relatively heavy selective tax on items in short supply. Obviously, these are the items which by themselves are needed for the defense program, such as machine tools, or the items whose labor or manufacturing capacity or transportation must be diverted to the defense program.

The decision between the excise tax and the various other methods of restricting consumption are intimately related to questions of fiscal policy, the normal operation of the price system, the dangers of inflation, and the prospect of unemployment in non-defense industries whose supplies have been shut off. They are specially related to questions of revenue. This paper does not approach these questions. It was restricted to excise taxation as a method of controlling consumption. It is to be hoped that the discussion which follows these papers will establish the criteria for choosing between the various methods which are available and for knowing how large a tax on any item is necessary to reduce its consumption by any given proportion.

CHAIRMAN ZOERCHER: We have one more paper, and then the meeting will be open for discussion on any of these papers that are given this afternoon.

The next on the program is Claude E. Wells, Jr., Central Division of American Petroleum Industries Committee, Chicago, and his subject is, "Effects of Specific Excises on Various Commodities," as it applies to gasoline.

CLAUDE E. WELLS, JR.: Mr. Chairman, Ladies and Gentlemen of the Conference: You of course are aware of the general subject of the conference this afternoon. I am going to try to discuss the effect of specific excises particularly upon gasoline.

EFFECTS OF FEDERAL EXCISES ON GASOLINE

CLAUDE E. WELLS, JR.

Central Division of American Petroleum Industries Committee

The general title of this discussion limits the papers to a consideration of federal taxation of specific commodities and in my case to the effect of the gasoline tax upon gasoline. Therefore, this paper will not include a discussion of state taxation of gasoline except insofar as is necessary for background and clarity in understanding the problem.

At the risk of some repetition of well-known facts, let us, for a moment, see what motorists are paying in the form of various kinds of taxes, and the role of gasoline taxes as a part of their total payments. Highway users are contributing a total of some two billion dollars annually to local, state, and federal governments. This sum constitutes more than 14 percent of the tax collections of all governmental units in the country. One and one-half billions of this total represents contributions to state and local governments; the remaining one-half billion represents payments to the federal government.

Of primary importance among these levies paid by these groups are federal, state, and local gasoline taxes, which account for more

than a billion dollars. State gasoline taxes amount to $870,000,000 annually. The duplicating federal levy, now collected at the rate of 1½ cents per gallon, adds something in excess of $300,000,000 to that figure. Since the enactment of the first state gasoline tax in 1919, such levies, together with the federal tax which has been collected since 1932, have taken from consumers of gasoline approximately eleven billion dollars.

In virtually every state the annual receipts from gasoline taxes now exceed the receipts from all taxes prior to World War I. States now derive, on the average, somewhat more than one-fourth of their total revenue from this particular source, and in three states the proportion approximates one-half of the total. No other single source of revenue produces so much income for state governments.

As of April 1, 1941, state gasoline taxes are equivalent to a sales tax of some 47 percent of the retail price paid by the consumer for gasoline. These state taxes now average 4 cents per gallon. The present federal levy stands at 1½ cents per gallon, a total tax of 5½ per gallon. An increase of 1 cent in the federal levy, as was recently proposed to the Congress, would increase the overall tax to 6½ cents, or the equivalent of a sales tax of 52 percent, based on the current retail price of gasoline (exclusive of the tax.)

The original gasoline tax, which was enacted by the State of Oregon, in 1919, was low, and the levy was accepted generally as an equitable method of raising revenue for the improvement of roads. Within ten years every state and the District of Columbia had adopted such a tax. Seldom, if ever, in taxing history, has a tax been accepted so universally in so short a period.

When the federal government enacted a gasoline tax of 1 cent per gallon in 1932, the states were already relying heavily on the gasoline tax as a source of revenue for the construction and maintenance of roads. The federal tax, however, unlike the state gasoline taxes, was enacted as a general emergency levy for the purpose of providing funds to replace a declining yield of revenue from established sources.

This first federal levy on gasoline was scheduled to expire in 1933. Although it was never intended as a permanent tax, it was, in 1933, on the grounds of emergency, not only extended to 1935, but raised to 1½ cents per gallon. During the latter half of 1933, therefore, the tax was collected at the higher rate—1½ cents per gallon. The rate reverted to 1 cent per gallon in 1934 when other revenues were made available by the repeal of the 18th amendment. As an indication of my contention that the federal tax was never intended to be a permanent tax, it is interesting to notice that this tax has been scheduled to expire on four different dates, but each time it has been extended. Congressional leaders had scheduled final expiration of the tax for June 30, 1941. Unfortunately, late in 1939 conditions overseas gave rise to a new and greater emerg-

ency—the need for national preparedness. It soon became apparent that the initiation of a program of re-armament in the interest of national security was a necessity, and all existing revenue sources were unchanged.

The recently approved Revenue Act of 1941 does not, as was proposed, further increase the federal tax upon gasoline. The arguments presented to the Congress by the petroleum industry and by organizations of highway users as to why a federal excise upon gasoline is not a desirable tax, and why an increase in the tax was not desirable upon such a commodity as gasoline, is basically the topic for discussion today.

In other words, the question of whether or not objection to the federal excise, or increase in the federal excise on gasoline, is sound, represents, in essence, the topic which I think the committee had in mind in scheduling a discussion of the effect of federal excises on gasoline.

In short, I should like to examine the federal excise from these three points:

1. Effect of a change (up or down) in the federal tax upon total consumption of gasoline in the United States, that is, the possibility of using the tax as a control device.
2. Effect of the tax on the people and industries using gasoline, that is, a consideration of the desirability of using this tax as a revenue device.
3. Attitude of the petroleum industry.

The first interpretation of the topic—the effect of a change in the federal tax upon consumption of gasoline—probably seems most pertinent to the defense program, since that program has the problem of transferring scarce resources from "non-essential" to defense uses. That is, would an increase in the federal excise tax reduce non-defense consumption of gasoline? Before discussing this question, I would like to say that I believe control becomes a valid use of a tax only when a shortage of so vital a commodity as gasoline exists. At this time there appears to be no need for alarm over any immediate or foreseeable shortage of petroleum products in the United States. Refinery capacity is available for an all-out defense effort without curtailing non-defense consumption. Leaders within the industry insist that the problem is simply one of transportation on the Eastern seaboard—a problem not only in the daily process of solution, but a local problem which an overall federal excise could hardy be expected to cure.

If a shortage *should* develop, could a federal excise then be used as an instrument of control? I don't know, but I doubt it. And I refer only to an excise at reasonable levels. The effect upon gasoline consumption of higher taxes is difficult to reduce to systematic data. Weather, season, location, the condition of local business

activity, the combination of all of these factors as applied to a single day or even a few hours make comparisons extremely difficult.[1] An examination of the best available data over the past few years shows a steadily increasing utilization not only of gasoline but of all petroleum products, despite continuous increases in taxes. In 1940 the total consumption of refined petroleum in the United States is estimated at 1,330,000,000 42-gallon barrels. In 1939 we find consumption at a 1,236,076,000 barrel figure—an estimated increase in 1940 of 94,000,000 barrels.[2]

The 1940 estimated domestic demand for petroleum products was 1,324,468,000 barrels; the 1940 estimated supply, 1,493,173,000 barrels. Compare these figures with 1935, in which year we find a domestic demand of 983,685,000 barrels. The 1935 supply amounted to 1,090,435,000 barrels.[3]

Selecting at random another comparison—the growth of motor fuel consumption by aircraft—in 1940 we find an estimated consumption of 225,456,000 gallons. This figure does not represent entire consumption, since some governmental departments are not reporting in the public interest. In 1932, including governmental aircraft, we find a total consumption of 54,058,431 gallons.[4]

The growth of petroleum consumption by all types of motor vehicles in the United States, exclusive of military vehicles, is indicated by the following figures:

In 1925, 17,321,000 vehicles consumed 8,700,006,000 gallons. In 1940 preliminary estimates indicated that 29,698,000 vehicles, exclusive of military types, would consume 22,032,654,000 gallons of gasoline—an increase in average consumption per vehicle from 502 gallons in 1925 to 742 gallons estimated in 1940.[5]

An examination of United States consumption of fuel oil (excluding kerosene) by uses, shows further that in 1934 domestic and commercial heating required 60,822,000 barrels, while in 1939 the same type of use required 139,452,000 barrels. Manufacturing and mines required 56,942,000 barrels in 1934; 67,043,000 barrels in 1939.[6]

[1] (a) Shifts in state sales tax amounts have not indicated a sound basis for determining the elasticity of demand. (b) Seasonal change in price should not be considered as an admission by the petroleum industry that they have any theories about elasticity of demand; i.e., all we mean is responsiveness to price changes.

[2] U. S. Bureau of Mines.

[3] U. S. Bureau of Mines.

[4] Civil Aeronautics Authority.

[5] U. S. Bureau of Mines, Public Roads Administration, Automobile Manufacturers Association.

[6] U. S. Bureau of Mines.

These comparisons have been selected to indicate types of consumption which in turn reflect the tremendous diffusion of petroleum products into almost every basic economic activity in the nation.

The figures indicate too that in spite of taxes over a long period of years, there has been an increase in consumption. Just because consumption of petroleum products has increased does not justify a legislator, or the public, in arguing that an increase in excise taxation is desirable, for in the majority of these uses of petroleum there are no substitute products readily available. For example, the fact of public reliance upon automotive transportation as a part of its everyday economic activity is too often dimmed by the spectacle of crowded highways during vacation months, weekends and holidays, as well as the influx of large numbers of passenger vehicles for all types of sports events, fairs, etc. The usage to which these same cars are put on other days of the week or during the other fifty weeks of the year is too often ignored. Pleasure driving accounts for only 29 percent of the use to which passenger cars are put, and it is not impertinent to suggest that such use may be concentrated in the higher income class.

But even if we admit that the poor use gasoline for pleasure, does that justify heavy taxation? Using tobacco as an example, Henry C. Simons in his *Personal Income Taxation* offers an excellent statement on this question. This same statement seems equally valid in the case of gasoline:

> "Many liberal persons defend levies like the tobacco tax on the curious grounds that tobacco is not a necessity—that poor people may or can avoid the burden by not consuming the commodity. This position invites two comments. First, it is hardly accurate to say that no burden is involved in getting along without the commodity. Second, it seems a little absurd to go around arguing that poor people could or ought to do without tobacco, especially if it is taxed, in the face of the facts that they simply do not do anything of the kind, that the commodity was selected for taxation because they are not expected to do so, and that the government would not get much revenue if they did. The plain fact, to one not confused by moralistic distinctions between necessities and luxuries, is simply that taxes like the tobacco taxes are the most effective means available for draining government revenues out from the very bottom of the income scale. The usual textbook discussions on these points hardly deserve less lampooning than their implied definition of luxuries (and semiluxuries!) as commodities which poor people ought to do without and won't."

With respect to a federal excise as a control device in connection with the operation of motor trucks, it should be apparent that no

decrease in consumption of motor fuel could possibly take place without impairing the present defense program. If therefore it is foolhardy to contend that under these circumstances a drop in truck usage would be desirable, it seems equally foolhardy to say that there should be an increase in the cost of hauling vital defense items.

That transportation systems are vital to defense should be obvious. Already trucks pay heavily in the form of licenses, fees, permits, gross weight fees, etc.; further increases in federal excises on parts, tires, etc., are bound to affect tariffs and transportation charges.

Not only trucks are vital, but cars also.

The federal Public Roads Administration indicates approximately two-thirds of the operation of private automobiles owned by farmers is for business purposes. This group of the population incidentally accounts for approximately 30 percent of all the passenger cars. Obviously the farmer will play an indispensable role in the provision of adequate foodstuffs in any defense effort. But why penalize him in the absence of exemption through increased taxation either of the gasoline which he consumes or the motor vehicle which he operates.[7]

Even in the case of residents of urban areas, these same studies show that in normal times slightly more than half of the operation of passenger cars represents business pursuits. There is compelling evidence, furthermore, that this percentage is increasing rapidly as a result of defense needs. One of the chief obstacles to satisfactory progress of the defense effort, it is known quite generally, has been the serious shortage of adequate housing facilities in the vicinity of industrial areas upon which there is the greatest dependence for fulfillment of the defense program. Only recently there has been considerable discussion of a projected public housing project in New Jersey which is being constructed especially for occupancy by defense workers and which, for physical and economic reasons, must be located some 17 miles from the plants in which its prospective residents are employed.

The same general trend is being shown in similar highly industrialized areas in other parts of the country. Certain specific illustrations might be cited. It appears, for example, that 82 percent of all the workers in Youngstown, Ohio, a steel center, drive to work in their own cars or ride with fellow workers. In Midland, Michigan, a chemical center, the figure is 92 percent, and in Glendale, California, an aircraft center, it is 87 percent.

Of the 3,442 municipalities in this country with a population in excess of 2,500 it has been found that 2,130, or approximately two-thirds of the total, possess no system of mass transportation whatever. Their residents are required, therefore, to rely for transportation solely upon their own private automobiles.

[7] *Automobile Facts and Figures.*

This definite proof of the direct dependence of industrial workers upon their own automobiles for transportation to and from their work seems to check quite closely with known facts concernnig the ownership of autombiles by income groups. Approximately 52 percent of all the car owners have a weekly income of less than $30 and a cumulative total of 70 percent have a weekly income of less than $40. Only 12 percent have an income of more than $60 per week.[8]

It seems quite clear that higher taxes either upon the gasoline consumed in such travelling or upon the cars themselves would cause increases in the cost of operating transportation facilities upon which defense workers must depend. In fact, it is not too difficult to envisage how such added costs would contribute to the current agitation for higher wages to offset the effect of the increased living costs.

As a control device, therefore, there is little to support the contention that an increase in federal taxes on gasoline would prove desirable. In so many cases, people just can't get along without consuming gasoline. If control were needed, certainly government and the petroleum industry can suggest other and better means. And again I wish to emphasize that at the present time there seems to be no indicated need for control.

From a revenue standpoint it is essential that we consider the effect of the federal excise on the people and the industries who must pay it; that is, on those who cannot reduce their consumption of gasoline. Reliance upon gasoline and petroleum products in our economic life is, as I have shown, so great that in my opinion the demand for gasoline is highly inelastic. The tax on gasoline, therefore, while not curtailing consumption of gasoline, may be effective in controlling consumption of other products. That is, a tax on gasoline increases expenditure of people if gasoline consumption is not curtailed, and the users of gasoline and lubricating oil in particular have less to spend for other products. Such a basis for the tax is hard to condone, for certainly gasoline consumption per se is not a test of ability to pay. The Congress of the United States seems to have recognized this fact, for the 1941 Revenue Act attempts to get increased revenues through lower exemptions in the income tax law rather than increases in the federal tax on gasoline.

That federal excises are not good fiscal devices is the conclusion of H. C. Simons' book, *Personal Income Taxation*, (page 220):

> "Save for the gasoline taxes and certain levies desirable for regulatory purposes, all excises, tariff duties, license taxes, and other miscellaneous regressive levies should be eliminated from both federal and state tax systems."

[8] *Automobile Facts and Figures.*

And on page 38:

> "It remains to mention another special instance in which benefit considerations support the ad rem type of levy—the case of the gasoline tax. (Taxonomically, this may be regarded as a special case in the pricing of particular public services, comparable to the tobacco case already noted.) Governments, constructing enormous networks of hard-surfaced highways, are thereby providing special services to persons as owners of pleasure cars and to enterprises employing motor transport (and to their customers). Since there can be no justification of deliberate subsidy either to the use of pleasure cars, or to persons as owners of pleasure cars, or to one form of commercial transportation as against another, there is the strongest case on both political and economic grounds for the imposition of special charges. The obvious system of toll charges, however, has been abandoned for good reasons; and the gasoline tax has been hit upon as an excellent device for accomplishing indirectly, and with a minimum of administrative difficulty and personal inconvenience, what it is inexpedient to attempt directly. The case is interesting as a rare instance in which a decisive argument can be made for a commodity tax."

Logically the defense of the gasoline tax is valid therefore only on the assumption that no diversion of highway funds occurs. To use gasoline taxes as a general revenue device only aggravates the inequality in real income existing today, since it is such a regressive levy.

An additional point against a federal excise as a revenue device is the fact that costs to the federal government are raised as a result of the tax. The federal gasoline tax is an excise of such nature that the government itself is paying the tax as a part of the price of many of the items needed for national defense. Airplane motors, for example, are placed upon blocks and operated forty-five to fifty hours. They are then torn down, checked, reassembled and given their final O. K. The gasoline consumed during the testing period by tens of thousands of these giant motors is all subject to federal excise tax. Oil and grease used in their lubrication, the gasoline, oil and grease used in testing constructed tanks, trucks, motorcycles and guns are all subject to the same excise. Thus, we see that the federal government itself is paying directly the tax which it has levied.[9]

[9] Federal tax on lubricants, oil, greases, and gasoline is a manufacturers' excise. At the time of sale to any manufacturer for use in connection with their business, there should be no federal instrumentality involved. There is no provision for exemption, and even if there were, it would not be sound.

In conclusion then, and to summarize my position, I do not believe that a federal excise tax is a good control device, even if control of gasoline consumption were necessary. Second, that the federal excises are not in general good fiscal devices. Third, that the federal gasoline tax is somewhat more excusable on the ground of fairness than other excises, provided that the revenues are properly used. The petroleum industry might not oppose gasoline taxes if the revenues are used for highway purposes, if highway construction costs are reasonable, and if highway planning is sound,[10] for the industry recognizes the part that good roads have played in, not only its growth, but the growth of many allied industries. Taxes make possible good roads—good roads increase the use of motor transportation—and increased motor transportation increases the consumption of gasoline. As a result of this increased consumption, costs and prices, exclusive of taxes, have steadily been reduced. But this admission is not to be interpreted as an endorsement of the tax on gasoline as a control, or as a general revenue measure.

CHAIRMAN ZOERCHER: Now the meeting is open for discussion. Has anybody any suggestions or any remarks? The meeting is up to you now.

JESSE A. MITCHELL (Missouri): I represent the "show me" state, and in the fall of 1943 we would like to show the National Tax Association something. We want you to come to St. Louis, Missouri, with your convention. We have reason to believe that St. Louis is the place the convention ought to be, for more reasons than one, chief among which is that we are more centrally located than any other city in our country. By that time the conditions which confront our country will have taken such a turn that it will be definitely known whether or not the hysteria of war and the necessities of increased activities and increased expenses along that line are apparent or whether or not the war will close and things will have receded to normalcy and we are going to have for ourselves the tremendous slump of postwar depression which we have heard so freely predicted here.

So, in either event, whether we are on the mountain-peak or in the lowlands, we have got to convene the convention in 1943 at a place where the greatest number of people from this country could assemble. In the light of those things, and being provided as we are with facilities of every kind for your entertainment, and so forth, we heartily invite you to bring the convention in 1943 to St. Louis, Missouri.

CHAIRMAN ZOERCHER: Does anybody else want to say something?

10 This is not to be interpreted as an argument for a federal highway system.

J. W. HUSTON (Illinois): I just want to say that the Illinois delegation on Monday held a meeting at which there were some 55 present. I think we have a larger delegation than any other state here, with the exception of Minnesota, and that has been true in the past. I just wanted to say that the Illinois delegation extends an invitation for the 1943 conference to be held in Chicago, and we hope that the Executive Committee will give it its very earnest consideration.

CHAIRMAN ZOERCHER: Mr. Bradley, don't you want to invite them to come down to Columbia, South Carolina?

W. R. BRADLEY (South Carolina): I have from time to time tried to inveigle this bunch into going down to South Carolina, and to the lower part of South Carolina, at that, down at the unique old city of Charleston, where we have within the State of South Carolina an independent republic from which you tax-gatherers can get a whole lot of ideas that you will never get anywhere else in the world. There is only one trouble about it, and that is that up to this time there isn't a hotel in Charleston quite large enough to accommodate this aggregation, because it seems to be growing every year. But I am going to test out the folks down there in Charleston and see if we can't make some arrangements by which we can have a central place down there and move the delegates backwards and forwards to this place, because there aren't enough hotel facilities in the town to take care of them. Charleston, you know, is not a large city like we have up north here—only about 75 or 80 thousand people. But it is a unique place, and I will guarantee you that if you go to Charleston—and you must do it some time in the near future—that will be one assemblage that will stand out in your memories as long as you live.

CHAIRMAN ZOERCHER: Is President Maxwell here? Come on. You take the chair now.

PRESIDENT MAXWELL: The Committee on Resolutions is ready to report.

MR. QUERY: The report of the Resolutions Committee, which I read this morning, is now ready for consideration and adoption, if you see fit.

The first resolution is:

> "WHEREAS the National Tax Association has appointed a committee to study and report on the problem of the coordination of federal, state, and local taxation; and
>
> "WHEREAS a considerable sum of money will be required to defray the expenses of such committee, be it
>
> "RESOLVED that the Committee on the Coordination of Federal, State and Local Taxation be authorized to raise the money

necessary to defray its expenses and that all moneys thus collected be payable to the Association, and be deposited by the Treasurer of the Association in a separate fund, to be drawn from said fund by the Treasurer on the order of the Chairman of said Committee; and

"Resolved that the Treasurer be empowered to open an account with a bank selected by him, for the purpose of this Resolution, and is authorized to amend the wording of this Resolution to meet the requirements of said bank for the deposit and withdrawal of funds."

The committee recommends the adoption of this resolution.

MR. EDMONDS: Mr. Chairman, I move it be accepted.

MR. COLE: Mr. Chairman, I am not quite clear about this resolution. Does it provide for the collection of funds to be paid to the treasurer of the committee, as distinguished from the treasurer of the association?

MR. QUERY: To be deposited by the treasurer of the association in a separate fund, to be drawn from said fund by the treasurer on the order of the Chairman of said Committee.

MR. COLE: The word is "Association," and not "Committee."

PRESIDENT MAXWELL: Are there any further questions? As many as favor the resolution, let it be known by saying "Aye."

(Ayes.)

PRESIDENT MAXWELL: Opposed, "No."

(None.)

PRESIDENT MAXWELL: The "Ayes" have it, and it is so ordered.

MR. QUERY: The next resolution:

"WHEREAS in 1926 the National Tax Association appointed a committee to confer with the American Bankers Association on the amendment of Section 5219 of the U. S. Revised Statutes (providing for the state taxation of national banks) authorizing the 'Fourth' alternative method which was duly enacted by Congress; and

"WHEREAS the American Bankers Association in its recent reply to the United States Senate Banking and Currency Committee questionnaire (dealing with national monetary and banking policy) has indicated the desirability of clarifying the 'Fourth' alternative method in that section provided, and also recommended authorizing the application of state sales and use taxes to national banks; and

"WHEREAS constructive changes have been made in state taxing systems since the last amendment of Section 5219 in

1926, such as the adoption of sales and use taxes by many states and minimum taxes on state banks in taxation measured by net income from all sources by some states; therefore be and it is

"RESOLVED that the thirty-fourth annual conference on taxation sponsored by the National Tax Association request the president of the Association to appoint a committee of five (two of whom shall be chosen from among the past presidents of the Association) to confer with an authorized committee of the American Bankers Association for the consideration of the amendment of Section 5219 as herein indicated."

The committee moves the adoption of this resolution.

SENATOR EDMONDS: Second the motion.

PRESIDENT MAXWELL: It is moved and seconded that the resolution be adopted. Is there discussion? If not, as many as favor the adoption of the resolution let it be known by saying "Aye."

(Ayes.)

PRESIDENT MAXWELL: Contrary, "No."

(None.)

PRESIDENT MAXWELL: It is adopted.

MR. QUERY: The third resolution:

"WHEREAS the Committee on Allocation of Income of the National Tax Association in a report rendered to the thirty-second annual conference on taxation held at San Francisco, California, in 1939, has arrived at certain conclusions and made certain recommendations with respect to allocation formulae where taxes are based on or measured by net income; and

"WHEREAS the said report has been discussed at this conference, now, therefore, be it

"RESOLVED that the thirty-fourth annual conference on taxation submits the report and recommends careful study be given the recommendations by all states and territories of the United States levying taxes on net income or franchise taxes measured by net income."

I want to say that the Resolutions Committee amended the resolution which was placed before it by changing the word "approves," to "submits," and changing the words "and favors the adoption of," to "recommends careful study be given to." The committee moves the adoption of this resolution.

LEO MATTERSDORF: I second the motion.

CHAIRMAN MAXWELL: Is there discussion? If not, as many as favor the adoption of the resolution let it be known by saying "Aye."

(Ayes.)

PRESIDENT MAXWELL: It is so ordered.

MR. QUERY: The fourth resolution—

CHARLES W. GERSTENBERG (New York): May I ask, were those remarks of the chairman of the committee a part of the record, the changes that were made?

MR. QUERY: It will be.

> "WHEREAS the United States of America is now on an 'all-out' war basis so far as defense spending is concerned; and
>
> "WHEREAS the cost of national defense vastly exceeds estimates current at the time of the 1940 National Tax Conference; and
>
> "WHEREAS the people of this country cannot avoid the increasing demands for taxes which the federal government is making and must continue to make upon them; now, therefore, be it
>
> "RESOLVED that it is the sense of the thirty-fourth annual conference of the National Tax Association that all tax-levying and tax-spending branches of government, federal, state, and local, should make every effort to curtail expenditures by the elimination of all non-essential activities, by effecting economies in the performance of the essential governmental functions, and by deferment of all projects not a vital part of the defense effort."

The committee recommends the adoption of this resolution.

SENATOR EDMONDS: I second the motion.

PRESIDENT MAXWELL: Is there discussion of this resolution? If not, so many as favor its adoption let it be known by saying "Aye."

(Ayes.)

PRESIDENT MAXWELL: Opposed, "No."

(None.)

PRESIDENT MAXWELL: It is adopted.

MR. QUERY: The fifth resolution:

> "WHEREAS the present emergency has vastly increased the revenue needs of the federal government; and
>
> "WHEREAS it is agreed that the national interest demands that these requirements be met in the common interest of national defense, therefore

"Resolved that it is important that in seeking additional revenues the federal government shape its tax policies so as to preserve the independence and autonomy of our state and local governments; and further

"Resolved that the federal government should give due consideration to state revenue needs and to the established sources of state taxation; and further

"Resolved that the states should be watchful in this situation and are under definite obligation to make their views known to federal agencies at this period of our history when their tax resources are endangered; and

"Resolved further, that while it is to be recognized that some states are at present enjoying a condition of revenue surpluses, this condition will not continue if the emergency should prove to be of long duration, and that all states should unite and present to the federal government their viewpoints of the impact of federal revenue legislation, present and future, on state and local revenues."

The committee recommends the adoption of this resolution.

Senator Edmonds: I second the motion.

President Maxwell: Is there any discussion of this resolution? If not, so many as favor its adoption let it be known by saying "Aye."

(Ayes.)

President Maxwell: Opposed, "No."

(None.)

President Maxwell: The resolution is adopted.

Mr. Query: The sixth resolution:

"Whereas the National Tax Association has lost one of its most valuable members in the passing of Charles Jesse Bullock, it is most fitting, in view of his peculiar relationship with the Association, which, in the minds of many, represents the core around which the Association for years has evolved, and which is still controlled by the principles that he so firmly established and persisted in through the many years that he was the counsellor and friend of the Association and its many members, that the thirty-fourth annual conference adopt this resolution, therefore be it

"Resolved that the thirty-fourth annual conference hereby make as a matter of permanent record in the proceedings of this conference, not only their deep appreciation and reverence for Professor Bullock, who through many years not only wrote and spoke in ways which made paths easier for those who are

engaged in public finance, but who also exemplified the forward-looking and responsive spirit on which the conference is founded; that while he was a strong exponent of the fundamentals which seemed not to have varied through the years, he was not unmindful of new aspects of those fundamentals and generously welcomed from all the expressions of means in which public finance could be improved and with unswerving devotion to what he considered the best principles in public finance, nevertheless tested all new proposals in the light of many years of experience;

"RESOLVED further, that a page in the Proceedings of the thirty-fourth annual conference be inscribed as a memorial to Professor Bullock, and that the Secretary be instructed to send a copy of this resolution to members of his family."

MR. GERSTENBERG: I move a rising vote on the resolution.

MR. SAXE: Mr. Chairman, I would offer an amendment to that resolution, if I may. That is, that when this thirty-fourth conference does adjourn, it adjourns out of respect to the memory of Professor Bullock.

MR. MATTERSDORF: I second the motion.

SENATOR EDMONDS: Mr. President, I second Dr. Gerstenberg's motion that we adopt the resolution by a rising vote.

PRESIDENT MAXWELL: First we will consider the amendment that has been offered. All those in favor of the amendment offered by Mr. Saxe of New York, let it be known by saying "Aye."

MR. LONG: Mr. President, I think everyone will agree with that, and I am of the opinion that Mr. Saxe is equally of the opinion that that is the best way to do it, but I am going to suggest to him—I am now just thinking out loud a bit—if it wouldn't be preferable, when this conference does adjourn, that by actual vote from the floor it adjourn, rather than have it in the resolution itself.

MR. SAXE: The suggestion is entirely acceptable. I will withdraw the motion.

PRESIDENT MAXWELL: The president took the liberty of expressing last night his opinion of the contribution made to this Association by Professor Bullock. It is moved and seconded that this resolution be adopted by a rising vote. All in favor will please stand.

(The entire assembly arose.)

PRESIDENT MAXWELL: The resolution is unanimously adopted.

MR. QUERY: Resolution No. 7: this originated with the Resolutions Committee:

"RESOLVED that the National Tax Association be requested to continue the Committee on Coordination of Federal, State, and Local Taxation, and the Excess Profits Tax Committee."

It was thought best by some to put this in the shape of a resolution, which we did. We move the adoption of this resolution.

SENATOR EDMONDS: Second the motion.

PRESIDENT MAXWELL: That recalls the suggestion of the Committee on Excess Profits that it be continued. It is a live subject. The motion is seconded that this resolution be adopted. Is there any discussion? If not, so many as favor it let it be known by saying "Aye."

(Ayes.)

PRESIDENT MAXWELL: Contrary, "No."

(None.)

PRESIDENT MAXWELL: The resolution is adopted.

MR. GERSTENBERG: May I inquire at this time if there are any other committees that should be discontinued?

MR. QUERY: There are none functioning.

MR. GERSTENBERG: There are no other committees? Do you understand that?

MR. LONG: There are no other committees. As a matter of fact, Mr. Gerstenberg, I think the suggestion contained in this resolution is desirable for this reason: on the one hand it is probably true that after you once appoint a committee and it has a continuing function and capacity, it keeps on forever, and we will, as you now indicate you have, perhaps lose sight of some committees that are functioning without being definitely assured of it.

I think it is probably the better practice to reexamine the committees that we have each year, and include them in the resolutions, and, so far as I know, these two are the only ones that are now functioning.

MR. QUERY: The eighth and last resolution:

"RESOLVED that the thirty-fourth annual conference on taxation, under the auspices of the National Tax Association, expresses its high appreciation to those in charge of arranging for the accommodation and entertainment of its delegates and guests, and particularly thanks all those participating in the program with contributions which evidence painstaking and studied efforts, and are a distinct contribution to tax literature."

The committee recommends the passage of this resolution.

SENATOR EDMONDS: I second the motion.

PRESIDENT MAXWELL: No doubt everyone here would like to arise and express his approval of this resolution.

SENATOR EDMONDS: I would like to say just a word on that resolution. I know that the ladies who have enjoyed so much the hospitality of the ladies of St. Paul would like a word of thanks to be said on their behalf. I do not know of any program which has ever been devised by this association in which the ladies have had such a helpful part as a result of the cooperation of the ladies of St. Paul. Senator Orr said in the very beginning that we would have an atmosphere of succulent seductiveness around us altogether. The ladies feel that they have been in that atmosphere, and it is due to the charm of their hostesses. So I am glad to say that on their behalf.

MR. QUERY: The committee will be glad to amend this resolution just to the extent that this body wants it done.

MR. LONG: Mr. President, in the Resolutions Committee meeting, Mr. Query called to attention that this resolution that is now before you for adoption was in the form that we have employed it for some time. It surely falls far short of any mark of any particular expression of exuberance on the part of the attendants at the conference as to those who have taken part, and it was my hope in the Committee on Resolutions that we would enlarge upon it substantially along the lines of the remarks made by Senator Edmonds. Of course, there are two dangers. The first danger is that you will overlook someone, and that therefore there will be an affront that you did not intend.

On the other hand, it seemed to me that while words may not mean all that should be meant, they still remain as the only method that we have of permanently expressing our appreciation of what St. Paul and its people have done for us. In this connection we would probably not go along with Talleyrand to the effect that words are made to conceal thought. I think all we have here are words to express our appreciation, and if we adopt the practice (and I am not arguing but what it may be a good one) of merely giving a very slight expression through words as this resolution calls attention, it may be proper.

These things do occur to me, however: first, that Senator Edmonds called to the attention of the group the tremendous amount of activity which the ladies of St. Paul and the ladies of Minnesota have done by way of helpfulness and actual work to make this such a splendid time for those who were attending the conference, and particularly the ladies, but there is also something more than that.

Many of the commercial activities of the city of St. Paul and Minneapolis, the University of Minnesota, the State of Minnesota, and probably in a great many ways that we can't begin to evaluate, have not only expended money but they have expended a great deal of energy to develop and present a great deal of talent and brought about a most wonderful entertainment.

There may be some who would argue that at these conferences we shouldn't have any entertainment. But when the people who are our hosts desire to do for us and will give the sort of entertainment which was furnished last evening, in addition to the constant evidences of generosity and hospitality which we have experienced since we arrived, I am rather of the opinion that it is not the complete resolution that it should be.

I am hoping that the group will be of the opinion that we should expand the resolution to really place with exactness at least definite recognition of those who have done much. This resolution leaves, as I see it, the thanks to the newspapers, for example, for giving some space in exactly the same position as that body of people that at great expense and a great deal of the exercise of energy made our evening session last night so wonderfully entertaining. Also, it seems to me that we should not be unmindful of the fact that this is one of the few states in which we have been where the Governor of the State has actually appeared, and the Mayor of the City has actually appeared, and have not sent in their place a substitute.

It occurs to me that we have not been in St. Paul, in this area, for a long while. The University of Minnesota has showed us the lamp of plenty. Therefore, I am of the opinion that this resolution should be more expressive of the many things that we really want to say to the good people of Minnesota.

PRESIDENT MAXWELL: What is the pleasure of the conference?

MRS. A. M. WENDT (Wisconsin): I am so heartily in favor of Senator Edmonds' resolution that I should like to see it incorporated as a separate resolution which would probably overcome all the objections that Mr. Long had. After all, that was a purely social part, and possibly had nothing to do with the business part of this conference. But as an old woman delegate to this convention, I feel especially indebted to these ladies, from the little girl in the elevator to the Governor's Lady, and I should like some special recognition of these ladies' graciousness to us. Thank you.

SENATOR EDMONDS: I didn't make a motion, Mr. Chairman, because I recognize the fact that the committee had done its best, and had done a very good piece of work. But in view of the sentiment expressed here on the floor, it seems to me that we might well have that resolution expanded; but I would like to see us adopt it now, because we have to adjourn at 5 o'clock.

I move that the resolution which was last read by Mr. Query be referred to Mr. Query and Mr. Long, and that in the form in which they perfect it, it be considered adopted by this conference.

MR. SAXE: Second the motion.

PRESIDENT MAXWELL: It is understood the question is to be put on the adoption of the resolution on the assumption that Mr. Query and Mr. Long—and who is the third?

SENATOR EDMONDS: I didn't name a third. I am satisfied with Mr. Query and Mr. Long.

PRESIDENT MAXWELL: It will be revised by the committee of three, consisting of Mr. Query, Mr. Long, and Mrs. Wendt, in line with the suggestions that have been made. In putting the motion, the chair is of the opinion that everyone here will feel better about it if they properly express our appreciation of the fine entertainment that has been given the ladies attending this conference.

As many as favor the adoption of the resolution as it will appear in that revised form, please rise.

(The entire assembly arose.)

PRESIDENT MAXWELL: It is so ordered.

(The resolution as so revised reads as follows—ED.)

> "RESOLVED that the thirty-fourth annual conference on taxation, under the auspices of the National Tax Association, expresses its real appreciation to the many persons participating on its program, particularly to His Excellency, Governor Harold E. Stassen, and His Honor, Mayor John J. McDonough, for honoring the conference with addresses; to the chairman of the Program Committee, Professor Roy G. Blakey, who was so largely responsible for the success of the conference; to the University of Minnesota for permitting the use of its excellent facilities; to the local committees on arrangements and entertainment who did so much in caring for the wants of the delegates and guests and providing them with a spectacular ice show; to the ladies entertainment committee for their unsurpassed graciousness and a series of memorable trips and visits; to the Association of Commerce, the press, and the many others who contributed so much to make this conference the success it was."

MR. QUERY: That completes the report of the Resolutions Committee.

PRESIDENT MAXWELL: If there is no business of the conference—

Mr. Long: Mr. Chairman, before you adjourn, I hope that you will accept Mr. Saxe's motion, that you adjourn the conference in honor of Professor Bullock.

Mr. Query: Mr. President, I move that the thirty-fourth annual conference do now adjourn, with the understanding that it is adjourned in respect to Dr. Bullock.

Senator Edmonds and Senator Saxe: I second the motion.

President Maxwell: It seems that the thirty-fourth annual conference of the National Tax Association is coming to its close, and I think the chair may, without immodesty, be permitted to say, because he has had very little responsibility for it, that he thinks it was one of the most interesting conferences of the association.

It is moved by Mr. Query, seconded by Senator Edmonds, that this conference be now adjourned in respect to the memory of our great friend, Professor Charles J. Bullock. As many as favor the motion, make it known by saying "Aye."

(Ayes.)

President Maxwell: The conference is adjourned.

Mr. Long: We should have a rising vote.

(The meeting thereupon adjourned, sine die, at 4:59 p. m.)

ANNUAL BUSINESS MEETING OF THE NATIONAL TAX ASSOCIATION

THURSDAY, OCTOBER 16, 5:00 P. M.

President Maxwell, presiding.

PRESIDENT MAXWELL: According to my watch, it is one minute to five o'clock. We rather got in the habit of changing our time in one way or another, so I think it wouldn't be any great violence to move it up that minute and call to order the annual meeting of the National Tax Association.

I believe the by-laws require that where a hundred delegates are attending a conference, twenty-five attending this meeting shall constitute a quorum. In the absence of some contrary opinion, the chair will assume that a quorum is present.

Notice of this meeting was duly given by publication in the monthly *Bulletin* for June, 1941, and was also carried on the program of this conference.

The next business of the association, I believe, is the report of the officers of the association—first that of the secretary, Mr. Manning.

SECRETARY MANNING: By vote of the executive committee of the National Tax Association, the present secretary was selected to fill the vacancy created by the resignation of Mr. Walter G. Query, effective January 31, 1941. This is a report on the Office of Secretary for the period from February 1, 1941 to date.

The principal activity of the office during the five months ending June 30, 1941, in addition to the handling of regular correspondence, was the collection of dues. A very large percentage of the total had already been collected prior to February 1, but there was still a considerable sum outstanding. Two bills, a personal letter, and a final notice were sent to all members remaining delinquent. A number of members indicated a desire to be dropped from the membership roll, and, in addition, about 18 others were finally dropped for non-payment. The present membership is 1207.

Bills for the current year were sent to all members in July, thus departing from the former practice of waiting until after the conference to send out notices. Payments have been received from between two-thirds to three-fourths of the total. Additional bills for dues not yet paid will be mailed after the conference.

As an initial step to secure new members, there were sent to about 500 individuals and firms copies of the program of the present con-

ference together with invitations to attend and participate in its deliberations. Application blanks were also enclosed.

As a measure for expediting the publication of the proceedings of this conference, a visit was made to the Wickersham Printing Company at Lancaster, Pa. From the printer it was ascertained that a considerable saving in time would result from an earlier receipt of the principal papers delivered at the conference. To that end, the persons preparing papers for the conference were urged to send copies thereof to the Secretary as early as possible. The papers of approximately one-third of all those to be presented were received, and edited, and sent to the printer. Galleys have been returned on most of these. It is hoped that the final volume can thus be completed at a much earlier date than otherwise would be possible.

A further change initiated this year has been a new style of presenting the program. The type of the program as set up for the October *Bulletin* was used and the same order of arrangement preserved. This is a departure from the former custom of printing in "time-table" form on the more costly colored paper. A considerable saving should thus be effected.

In accord with the established practice of the Association, the Governor of the host state was requested to invite the governors of all the other states, territories, and possessions, as well as the provinces of Canada, to send delegates to this conference. About 41 states, and 2 provinces of Canada, as well as the governor of the Hawaiian Islands, have complied with this request.

The Secretary this year, in addition to performing the duties of secretary and serving on the Program Committee, also prepared his usual paper summarizing the state tax legislation of the year.

The Secretary has had the most willing and helpful cooperation of Mr. Query and his assistant, Miss Julia Hodge, and wishes to record his appreciation therefor.

Mr. Long: I move that the secretary's report be accepted.

(The motion was duly seconded.)

President Maxwell: It is moved and seconded that the report of the secretary be accepted. As many as favor that will let it be known by saying "Aye."

(Ayes.)

President Maxwell: Contrary?

(None.)

President Maxwell: It is so ordered.
Next is the report from the treasurer of the association, Mr. Eby.

Treasurer Eby:

National Tax Association

Report of Treasurer for Year Ended June 30, 1941

Receipts and Disbursements

Balance in Bank July 1, 1940		$2,578.65
RECEIPTS		
Association Activities		
Dues	$5,720.00	
Sales of publications	402.56	
Subscriptions to *Bulletin*	164.00	
Total	$6,286.56	
Investment Income		
Interest	$1,305.75	
Dividends	180.60	
Total	$1,486.35	
Other Income		
Contributions	$1,409.85	
Redeemed Bonds	$2,080.00	
Total Receipts		$11,262.76
Total balance in bank and receipts		$13,841.41
DISBURSEMENTS		
Administrative		
Secretary—clerical services	$1,500.00	
Postage, printing and stationery	284.57	
Miscellaneous	176.25	
Total	$1,960.82	
Proceedings		
Printing Volume 33	$2,344.07	
Reprints	117.58	
Total	$2,461.65	
Bulletin		
Printing Vol. 25, No. 9 and Vol. 26, Nos. 1-8	$1,883.82	
Reprints	100.60	
Total	$1,984.42	
Conference		
Reporter—Minutes	$ 225.62	
Printing and postage	77.82	
Traveling expenses	111.75	
Total	$ 415.19	

Miscellaneous		
Rental of safe-deposit box	$ 8.33	
Exchange on checks deposited	2.57	
Total	$ 10.90	
Funds Invested		
Cost of bonds purchased	$4,990.00	
Total disbursements		$11,822.98
Balance in Bank June 30, 1941		$ 2,018.43

From this statement of receipts and disbursements is summarized the following:

INCOME STATEMENT

Association Activities

Income	
Dues, sales of publications and subscriptions to *Bulletin*	$6,286.56
Expense	
Administrative, proceedings, bulletin, conference and miscellaneous	6,832.98
Excess of expense over income	$ 546.42

Other Income

Interest and dividends	$1,486.35
Contributions	1,409.85
Total	$2,896.20
Net Income	$2,349.78

NET PROFIT ON REDEMPTION OF BONDS

During the year, two bonds which cost $2,007.50 were redeemed for $2,080.00, resulting in net profit of $72.50.

CHANGES IN INVESTMENT SECURITIES

Book value of securities owned July 1, 1940		$35,470.67
Book value of bonds acquired	$4,990.00	
Book value of bonds redeemed	2,007.50	
Net increase		2,982.50
Book value of securities owned June 30, 1941		$38,453.17

ROBERT J. EBY,
Treasurer.

REPORT OF AUDIT

I have audited the accounts of the National Tax Association as maintained by the Treasurer for the year ended June 30, 1941 and verified by personal examination the securities owned as at that date. All cash received during the period, according to reports of remittances made to the Treasurer by the Secretary, and to other records in file, was found to have been deposited in bank to the credit of the Association, and all disbursements were found to be supported by receipted bills or other satisfactory data.

Subject to the foregoing, it is my opinion that the appended Report of Treasurer correctly sets forth the financial results of the Association's activities for the year, and the balance in bank and investment securities owned as at June 30, 1941.

EDWARD F. NEAL,
Auditor.

NEW YORK, N. Y.
SEPTEMBER 30, 1941.

MR. EBY: This report was approved by the executive committee.

MR. LONG: I move its acceptance and approval.

(The motion was duly seconded.)

PRESIDENT MAXWELL: It is moved and seconded that the report be received and approved. Is there any discussion? As many as favor the motion, let it be known by saying "Aye."

(Ayes.)

PRESIDENT MAXWELL: Contrary?

(None.)

PRESIDENT MAXWELL: It is so ordered.

MR. GERSTENBERG: May I ask just one question, Mr. Eby? Does the cost of the proceedings include the cost of the reporting? Or is that a separate item, $2,300?

MR. EBY: That is the printing of the book.

MR. GERSTENBERG: The cost of the reporting is not included?

MR. EBY: No.

MR. GERSTENBERG: How many copies were printed, do you know?

MR. EBY: 1350, I think.

PRESIDENT MAXWELL: We probably have some more oratory ahead of us. It is customary for the association to elect a president, vice-president, secretary, and treasurer, and this year we have three members of the executive committee to elect, and two honorary members for the Dominion of Canada. Who is chairman of the Committee on Nominations?

MR. LONG: Mr. President, the Nominating Committee is composed of the former presidents of the Association who are present, and the three named by the presiding officer in the persons of Senator Orr of Minnesota, Senator Saxe of New York, and Mr. Stevens of California, who joined with the former presidents who were present in their meeting to consider this question of the officers of the association. Mr. Joseph Matthews, who you will note is one of the former presidents of long years' service, was selected as chairman of the Nominating Committee.

For convenience, they suggested that former President Long act as secretary, and subsequently President Matthews, being unable to remain until this meeting, requested that the secretary read the nominations, which the secretary of the Nominating Committee will now proceed to do.

Before doing that, I would like to ask, Mr. President, whether it is the practice to select each office and indicate the name, and then ask for a vote on that name, or whether it is the practice to present the whole slate and then vote on the whole slate, or having read the whole slate, go back and take them up individually? It is my thought that the Nominating Committee should present one name at a time, and that should be voted on; but I am not positive that that is the practice.

MR. ZOERCHER: Mr. Chairman, I think the committee should submit its full report, and if this meeting wants to adopt the full report, it is up to the meeting. But he should make a full report.

PRESIDENT MAXWELL: Read your report, and then I will submit the question to the conference.

MR. LONG: The Nominating Committee having considered this has made the following selections, and now nominates for your consideration and urges the adoption of the report and the selection of these persons, as follows:

President: Seth T. Cole of New York.
Vice-President: Walter G. Query of South Carolina.
Secretary: Raymond E. Manning of the District of Columbia.
Treasurer: Robert J. Eby of New York.

As your presiding officer has indicated, there are three whose terms on the executive committee expire by virtue of the run of the three-year period, and in their places the committee recommends for your adoption—

John A. Scott of Duluth, Minnesota,
Dixwell L. Pierce of California,
William R. Pouder of Nashville, Tennessee.

Following the practice of the association and in mark of respect to the friendly relations that not only are established but are con-

tinuing to be more effective, they offer as honorary members of the executive committee:

Mr. Stuart Garson of Manitoba,

Mr. Albert K. Eaton, of the Department of Finance of Canada, who has been previously an honorary member.

The Nominating Committee, Mr. President, recommends the adoption of the report and the selection of these persons named for officers in the ensuing year.

PRESIDENT MAXWELL: What is the pleasure of the association? Shall we vote on these separately?

SENATOR EDMONDS: Mr. Chairman, I move that the report of the committee be approved, that the secretary cast the ballot according to the names placed in nomination by the committee, and in a collective ballot, and that the nominees be declared elected after they have been so chosen.

MR. ZOERCHER: I second that motion.

CHAIRMAN MAXWELL: I presume you all understood the motion, that the report of the committee be adopted as a whole, and that the nominations recommended by the committee be ratified by the conference through the casting of the ballot by the secretary. So many as favor the adoption of that motion will please let it be known by saying "Aye."

(Ayes.)

PRESIDENT MAXWELL: Contrary, "No."

(None.)

PRESIDENT MAXWELL: The chair holds that they are elected, and it will be so recorded in the minutes of the meeting.

Is there any new business that anyone has to suggest to this meeting?

SENATOR EDMONDS: Mr. President, I would like to move that the association express its thanks to the retiring president, Mr. Maxwell, the vice-president, Mr. Cole, the secretary, Mr. Manning, and the treasurer, Mr. Eby, for their services to the association during the past year. This has been a most happy year, culminating in one of the most successful conferences that we have ever had, and I personally would like to make this motion in order to put on record how glad I am that North Carolina and South Carolina didn't get out of the union when they tried.

MR. SAXE: I second the motion.

MR. ZOERCHER: I will second that motion.

SENATOR EDMONDS: I will put the motion, Mr. President. All those in favor please say "Aye."

(Ayes.)

SENATOR EDMONDS: Contrary minded?

(None.)

SENATOR EDMONDS: Mr. Maxwell, you and your colleagues are thanked, very heartily and sincerely.

PRESIDENT MAXWELL: I am grateful to you all for the privilege of having served such a fine organization in the inaedquate way in which I have.

SECRETARY MANNING: Mr. Chairman, if it is in order for the secretary to offer a motion, I would offer one, that a vote of thanks of this association be given to Mr. Query and Miss Hodge for the fine way in which they have assisted this Association and the secretary. I offer that motion.

(The motion was duly seconded.)

PRESIDENT MAXWELL: As many as favor that motion, let it be known by saying "Aye."

(Ayes.)

PRESIDENT MAXWELL: It is so ordered.
Mr. Eby, you are recognized to take a bow.

MR. EBY: I express my thanks.

PRESIDENT MAXWELL: I was under the impression that I was out of a job with these gentlemen at this meeting, but I find this memorandum here, and I have checked on it and understand it hooks up with the by-laws of the organization, and I think an amendment to it was adopted perhaps last year, that I get another thirty days' pay. And that the terms of office of these new officers begin thirty days after this date.

I am going to take the liberty of asking our new president to come to the platform and take a bow and give us as much of an oration as he feels inclined to make.

Before doing so, I am going to make the observation that it appears that the Association will be in capable and experienced hands for the ensuing year in its president, its vice-president, its secretary, and its treasurer. Mr. Cole.

(The members arose and applauded.)

PRESIDENT-ELECT COLE: Ladies and fellow members of the National Tax Association: I know that it is not customary for the incoming president to make an address on this occasion—quite properly so, because he does not take office for a period of thirty days.

Nevertheless, I do wish to express my sincere thanks and appreciation to the members of the Association for the high honor which they have conferred upon me. I am humbly and duly grateful.

There are one or two things that I think perhaps should be said. First of all, I want to join my voice with the others in praise of the splendid entertainment that has been provided by the local committee of arrangements for this conference. I have been attending, I think almost without exception, these National Tax Conferences for a period of seventeen years, and in that time I have known of no other conference at which entertainment and hospitality rose to such heights as they have here in St. Paul.

At the same time, I think we ought not to get into the way of feeling that it is necessary that each city that entertains the association should outdo the preceding one. In other words, we ought not to reach the point where we are trying to keep up with the Joneses. So, as this is a working conference, and its social activities are secondary, I hope that any city which in the future may see fit to extend us an invitation, will feel at liberty to arrange its entertainment program in accordance with its own desires and abilities.

Last night, in the presidential address, President Maxwell elaborated upon the history of the National Tax Association and upon its accomplishments of the past. We have a history of which we may well be proud. The time at present indicates that our opportunities for service in the future will be as great if not greater than they have been in the past.

We have heard throughout this conference considerable discussion upon the question of what proper part taxation should play in governmental affairs. On the one hand we have heard from those who believe that taxation should be used in part for regulatory purposes. On the other hand we have heard from those who advocate taxation for revenue only. Professor Gulick this morning made the suggestion that there might be a dress rehearsal revolving around that issue at the conference in Cincinnati. It occurred to me that there was merit in the suggestion, and I shall bring that to the attention of the Program Committee for the Cincinnati conference when it is appointed. Certainly there is a diversity of thought, and when there is a diversity of thought on matters relating to taxation, the National Tax Conferences are an appropriate forum for discussion.

The association has two important committees functioning—one, the Committee on Excess Profits Tax; the other, the Committee on Coordination of Federal, State, and Local Taxes. Both of these committees have been continued for another year. The work assigned to each is of the utmost importance.

When taxing systems (if we may call them systems) are being built up, it is almost impossible to pay a great deal of attention to symmetry in design. The tendency always is to merely fix a new

tax when new revenues are necessary that will reach the public pocketbook with the least amount of trouble and difficulty.

It is entirely different from, let us say, designing a house when the architect lays out his plans and specifications and construction follows in accordance therewith. The tax architect could do a good job if he were permitted to start from scratch and lay out a taxing system. But it seems that after this present defense, or war emergency, as you may choose, shall have ceased, there should be a great tapering off in the tax collections. Then will an opportunity be offered to take some constructive measures toward setting our tax structure in order.

Therefore, it is my hope that the Committee on Coordination of Federal, State, and Local Taxes will prosecute its work with vigor, and with the conditions which are to follow the war particularly in mind, to the end that we may embrace this opportunity to set our house in a little better order than it is in at present.

In conclusion, I want to say to you that I shall be at the service of the members of the Association. I want each member to feel at liberty to write me or confer with me at any time in connection with any matter relating to the affairs of the association, and during the period that I hold the office of president, I shall endeavor to do those things which will advance the interests of the association and leave undone those things which would have a contrary effect.

I thank you.

President Maxwell: If there is a better tax administrator south of North Carolina than W. G. Query of South Carolina, I don't know who he is. It is just possible that there may be some two or three new members here who don't know Mr. Query, so I am going to ask Mr. Query to come up here.

Vice-President-elect Query: Vice-presidents are supposed to be seen and not heard. I have always felt that a vice-president should stay in the background but help in every way that he could in the work of the association.

I endeavored to serve the Association to the extent that might be required of a secretary, both during the annual conferences and throughout the year, when I was secretary. I enjoyed this work and resigned only upon the advice of my physician.

The action of the conference in New York last year impressed indelibly upon me that I had friends, numerous friends, close friends, and I am sure that if it had not been for my doctor telling me it was necessary for me to lessen my work I would have been your secretary yet, if you had elected me. Since you now again honor me by electing me you vice-president, I am overwhelmed.

All I can say is that I appreciate the honor and hope that with renewed vigor I may be able to serve the association in the future.

President Maxwell: You may recall that at the meeting in New York last year, we refused to follow Mr. Query's wishes and request, and at that time elect a new secretary, in the hope that he might find it possible to renew that work. I am sure that we are all pleased with his regaining his health and that we are glad to give him this recognition for the long and valued services he has rendered this association.

Is there any further business now to come before the association at this time?

Mr. Long: By the way, Mr. President, have I been out of the room when there was an announcement of the number of states represented here and the total number of delegates?

President Maxwell: I don't recall that any announcement has been made, other than the one I made last night. There were 42 states represented up to last night, and three of the provinces of Canada, a total registration—let me see if I have the figures here—of 659, of whom 113 were ladies.

There has been nothing added to that today, has there?

Secretary Manning: Just what the number of additions has been, I don't know. But I have seen at least three or four people register myself. Mrs. Manning probably has the final figure. I will get it.

President Maxwell: Mr. Long, while Mr. Manning has gone to get that figure, you might sell a few more copies of the proceedings for us by giving us another story.

Mr. Long: I am afraid that I have told this story before, but I think it is in line with some of the things that we have had. During the early days of the depression in Massachusetts a great many of the officials, even though they had handled public welfare through the years, were so much impressed by it that it worried them, and they took home the story to their families.

One of the public welfare people told night after night in his household the story of the distress that he was discovering—people that he had long known, occupying good positions, losing them; persons whom he least suspected of being obligated, having to go on public welfare. One after another seemed, as he saw them on the street, to be looking seedier and seedier, and more and more in distress.

He had an aunt who was rather a recluse. She was very much impressed by it. But she was also a very generous soul. A day or two after he had told her the most harrowing details, she was in the center of the city, going to her destination in a department store, and found a very seedy, dejected-looking individual leaning up against a building. She immediately thought of the stories she

had heard about distress, and vowed then and there to do something herself. So she surreptitiously took a two-dollar bill out of her purse and went up to the seedy-looking gentleman leaning against the building, and surreptitiously slipped the two-dollar bill in his hand and whispered in his ear, "Don't despair. Don't despair," and went about her tasks, firm in the belief that she had accomplished something really worth while in the thought that perhaps she had given him a little cheer for a longer period.

In two or three days she had occasion to go back to the store to exchange some of the purchases she had made, and as she went toward the store was much surprised to see this same dejected-looking individual leaning up against the building in the same way as she had first seen him. But before she could get to him, because she was wondering in her mind just what she should do, he spied her, and hurried toward her, and put into her hand a pile of bills, currency of the United States. She was very much upset, and trembled, and just couldn't say anything. He finally, taking pity on her, said, "It's all right, lady. It's all right. It's all yours. Don't Despair was a 20-to-1 shot."

President Maxwell: What is the further pleasure of this association?

Mr. Mattersdorf: Mr. Chairman, may I just ask one favor of the person who is going to do the index, that he please index Commissioner Long's stories.

President Maxwell: The secretary will make a note of that. I want to suggest that Mr. Long get a notebook and begin to take notes, so that we will have an array of them at the next conference, equal to what he has presented to this one.

Mr. Zoercher: Mr. Chairman, I move that we now adjourn.

Mr. Terry: What was the registration?

President Maxwell: Oh, yes. I was so much interested in that story, it got away from me. There were 551 men registered, 114 ladies, and a total of 665.

Do I have a second to Mr. Zoercher's motion?

Mr. Gerstenberg: I second the motion.

President Maxwell: It is moved and seconded that this association do now adjourn. As many as favor the motion say "Aye."

(Ayes.)

(The meeting thereupon adjourned, at 5:45 o'clock p. m.)

ATTENDANCE AT THIRTY-FOURTH ANNUAL CONFERENCE

ALABAMA

Curry, John C.	Commissioner of Revenue	Montgomery

ARIZONA

Peterson, Warren	Tax Commissioner	Phoenix
Peterson, Mrs. Warren	506 West Vernon Ave.	Phoenix

ARKANSAS

Cox, Geo. P.	State Comptroller's Office	Little Rock
Gentry, Leffel	General Attorney, Arkansas Revenue Dept.	Little Rock
Gentry, Mrs. Leffel	5101 Lee Ave.	Little Rock
McLeod, M. B.	State Comptroller	Little Rock
Nickerson, W. A.	C. R. I. & P. Ry. Co.	Little Rock

CALIFORNIA

Adams, Charles	Union Pacific R. R.	Los Angeles
Allen, Walter R.	Chief Asst. Assessor of San Francisco	San Francisco
Buchanan, Robert	Lybrand, Ross Bros. & Montgomery	San Francisco
Mott, A. G.	State Bd. of Equalization	Sacramento
Mugford, T. H.	State Bd. of Equalization	Sacramento
Pettengill, Robert B.	University of So. Calif.	Los Angeles
Pierce, Dixwell L.	Secy. State Bd. of Equalization	Sacramento
Say, Harry L.		Sacramento
Stevens, Harley C.	Standard Oil Co. of Cal.	San Francisco
Thompson, Frank T.	A. T. & S. F. Ry.	Glendale
Thompson, Mrs. Frank T.	1540 No. Pacific Ave.	Glendale

COLORADO

Baker, C. C.	Colo. Central Power Co.	Golden
Gobble, Berton T.	Asst. Atty. Genl. and Inheritance Tax Comnr.	Denver
Seaman, J. R.	Colorado Tax Commission	Denver
Vorderman, J. A.	The Texas Co.	Denver

CONNECTICUT

Atkins, Carter W.	Governmental Research Inst.	Hartford
Clarke, G.B.	State Tax Dept.	Hartford
McLaughlin, Chas. J.	State Tax Commission	West Hartford
McLaughlin, Mrs. C. J.	361 Fern St.	West Hartford
Oakes, Eugene	Yale University	New Haven

DELAWARE

Daugherty, M. M.	University of Delaware	Newark
Gassaway, Gerrish	Chamber of Commerce	Wilmington
Nowland, John W.	Director, Tax Research Bur.	Wilmington
Nowland, Mrs. John W.		Wilmington
Truss, James P.	State Tax Commissioner	Wilmington

DISTRICT OF COLUMBIA

Bigos, Miss Elizabeth H.	Federal Housing Adm.	Washington
Coleman, J. R. Jr.	Chesapeake & Potomac Tel. Co.	Washington
Craig, David R.	Amer. Retail Fed.	Washington
Dearing, Charles	Brookings Institution	Washington
Eccles, Marriner S.	Bd. of Gov., Fed. Res. Sys.	Washington
Gerig, David S.	Social Security Board	Washington
Gray, Welles A.	U. S. Chamber of Commerce	Washington
Groves, Harold M.	Treasury Department	Washington
Gulick, Luther	Consultant, U. S. Treasury	Washington
Hall, R. C.	Forest Taxation Inquiry	Washington
Hoan, Daniel W.	Chief Field Operation Civil Defense	Washington
Kades, Charles L.	Asst. General Counsel for the Treasury	Washington
Labovitz, I. M.	U. S. Bureau of Budget	Washington
Lee, Alvin T. M.	Bureau of Agricultural Economics	Washington
MacLeod, Donald R.	Fruit Growers Express Co.	Washington
Manning, Raymond E.	Library of Congress	Washington
Manning, Mrs. R. E.	6343 Utah Ave. N.W.	Washington
Morgan, Jo V.	Board of Tax Appeals, D. C.	Washington
Parker, Lovell N.	Guy & Brookes, Attys.	Washington
Thomas, Charles M.	Public Relations Counsel	Washington
Wallace, Wilton H.	Attorney	Washington
Wallace, Mrs. W. H.		Washington

FLORIDA

Chance, H. J.	Asst. State Comptroller	Tallahassee
Lummus, J. N. Jr.	Dade County Tax Assessor	Miami
Owens, Jas. M. Jr.	State & County Tax Assessor	Palm Beach
Ward, W. G.	Attorney	Miami
Wood, Hayes	State & County Tax Collector	Miami

GEORGIA

Hunter, Joel	Cert. Public Accountant	Atlanta

ILLINOIS

Adams, Robert M.	Adams, Nelson & Williamson	Chicago
Aldrich, J. H.	Western Union Tel. Co.	Chicago
Allen, H. K.	University of Illinois	Champaign
Allen, Mrs. H. K.	1501 W. University Ave.	Champaign
Allyn, C. B.	Jewel Tea Co. Inc.	Barrington
Angell, J. B.	Rock Island Lines	Chicago
Angell, Mrs. J. B.	2237 W. 109th St.	Chicago
Avery, William H. Jr.	Sidley, McPherson, Austin & Burgess	Chicago

Barrett, P. T.	C. & W. I. R. R. Co.	Chicago
Blaise, F. J.	The Pure Oil Co.	Chicago
Blanc, S. F.	C. B. & Q. R. R.	Chicago
Boettel, Fred W.	Pub. Ser. Co. of No. Ill.	Chicago
Brown, Adelbert	Attorney	Chicago
Bundy, R. G.	C. M. St. P. & P. R. R. Co.	Chicago
Burtch, S. D.	The Pullman Co.	Chicago
Catanach, W. A.	Pennsylvania R. R.	Chicago
Chase, H. G.	The Pure Oil Co.	Chicago
Chase, L. P.	C. B. & Q. R. R.	Chicago
Conlon, Charles F.	Fed. of Tax Administrators	Chicago
Conlon, Mrs. Charles F.	7124 S. Ridgeland Ave.	Chicago
Connellee, Linwood	Lawyer	Ottawa
Connellee, Mrs. E. L.	630 Webster St.	Ottawa
Culver, C. L.	C. M. St. P. & P. R. R.	Chicago
Cushing, Royal B.	Attorney	Chicago
Cushing, Mrs. R. B.		Wheaton
Danis, R. S.	Illinois Tax Commission	Chicago
Deaton, W. E.	E. J. & E. Ry.	Joliet
Deaton, Mrs. W. E.		Joliet
Dodd, Walter F.	Dodd & Edmunds, Attorneys	Chicago
Edmunds, Palmer D.	Dodd & Edmunds, Attorneys	Chicago
Edmunds, Mrs. P. D.	30 N. La Salle St.	Chicago
Edwards, O. G.	C. M. St. P. & P. R. R. Co.	Chicago
Edwards, Mrs. O.G.	510 Lee St.	Evanston
Fairlie, John A.	University of Illinois	Urbana
Fairweather, George O.		Chicago
Feldman, Maurice J.	Attorney	Chicago
Fiske, Thos. E.	Taxpayers Fed. of Ill.	Springfield
Fiske, Mrs. Thos. E.	East Hazel Dell	Springfield
Foley, Wilbert M.	Cook County Assessor's Office	Chicago
Ford, J. R.	Alton & Southern R. R.	E. St. Louis
Ford, Mrs. J. R.	1510 N. 45th	E. St. Louis
Ford, Bettie Louise	1510 N. 45th	E. St. Louis
Garvey, John J.	County Assessor's Office	Chicago
Green, H. F.	The Alton R. R. Co.	Chicago
Green, Mrs. H. F.		Chicago
Gregg, John H.	Asst. Tax Commissioner C. & N. W. Ry. Co.	Chicago
Griffenhagen, E. O.	Griffenhagen & Associates	Chicago
Hays, Jos. H.	West. Asso. of Ry. Executives	Chicago
Hirsh, Leon S.	Asso. Ry. Equip. Owners	Chicago
Holt, Robert N.	Attorney	Chicago
Hunter, Merlin H.	University of Illinois	Urbana
Hunter, Mrs. M. H.	608 Penna. Ave.	Urbana
Huston, J. W.	Sup. Research & Statistics	Springfield
Huston, Mrs. J. W.	2036 So. State St.	Springfield
Jacobs, J. L.	J. L. Jacobs & Co.	Chicago
Jones, David R.	Montgomery, Ward & Co.	Chicago
Kaiser, Arthur R.	Sears, Roebuck & Co.	Chicago
Koncil, Ed.	C. & E. I. R. R. Co.	Chicago
Leber, C.	Peoria & Pekin Union Ry. Co.	Peoria
Leland, Simeon E.	University of Chicago	Chicago
Lepawsky, Albert	Fed. of Tax Administrators	Chicago
Lyons, Richard J.	Illinois Tax Commission	Chicago
Maloney, Joseph A.	Barrow, Wade, Guthrie & Co.	Chicago
Marshall, Logan W.	Pure Oil Co.	Chicago
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OKLAHOMA

Branan, Herbert L.	Okla. Tax Commission	Oklahoma City
Cash, O. C.	Stanolind Pipe Line Co.	Tulsa
Davis, G. W.	Shell Oil Co.	Tulsa
Dunn, J. D.	Okla. Tax Commission	Oklahoma City
Gilbough, F. M. Jr.	M. K. T. R.R. Co.	Oklahoma City
Lattin, H. B.	Skelly Oil Co.	Tulsa
Meyer, Leo	Mid-Continent Pet. Corp.	Tulsa
Nation, H. W.	S.W. Bell Tel. Co.	Oklahoma City
Plank, F. B.	Cities Service Oil Co.	Bartlesville
Pyle, T. Myron	Okla. Gas & Elec. Co.	Oklahoma City

OREGON

Collins, T. B.	Union Pacific R. R. Co.	Portland
Collins, Mrs. T. B.	3435 S.W. Heather Lane	Portland

PENNSYLVANIA

Bachrach, Michael D.	C. P. A.	Pittsburgh
Bowser John V.	Westinghouse Air Brake Co.	Pittsburgh
Edmonds, Franklin S.	Attorney-at-law	Philadelphia
Edmonds, Mrs. F. S.		Whitemarsh
Elkin, E. M.	Westinghouse Elec. & Mfg. Co.	Pittsburgh
Fox, Leonard P.	State Chamber of Commerce	Harrisburg
Hoffman, Valentine P.	Dept. of Revenue	Harrisburg
Howe, Arthur W. Jr.	Deputy Auditor General	Harrisburg
Hughes, Joseph D.	Pittsburgh Plate Glass Co.	Pittsburgh
Hughes, Mrs. J. D.	The Arlington	Pittsburgh
Jennings, James J.	State Treasury	Harrisburg
Johnston, Samuel	Gulf Oil Co.	Pittsburgh
Kalisher, S. S.	Tax Consultant	Philadelphia
Kraft, H. F.	Penna. R. R. Co.	Philadelphia
Krekstein, I. H.	C. P. A.	Philadelphia
Kress, Walter J.	Acting Sec. of Revenue	Harrisburg
Kress, Mrs. W. J.	2117 Walnut St.	Harrisburg
Logan, Edw. B.	Budget Secretary	Harrisburg
Margolis, Harry		Harrisburg
Martin, W. W.	Westinghouse Air Brake Co.	Pittsburgh
Martin, Mrs. W. W.	7524 Tuscarova St.	Pittsburgh
Mulvihill, Thos. J.	Gulf Oil Corp.	Pittsburgh
Reist, Linn L.	Dept. of Revenue	Harrisburg
Rowe, I. C.	Pitts. Equitable Meter Co.	Pittsburgh
Scott, Chas. L.	Westinghouse Elec. & Mfg. Co.	Pittsburgh

Scott, Mrs. C. L.	6937 Thomas Blvd.	Pittsburgh
Shea, Norman J.	Accountant & Tax Consultant	St. Davids
Shockley, E. Russell	Deputy Atty. General	Harrisburg
Sinon, Frank A.	Deputy Atty. General	Harrisburg
Walker, Mabel L.	Tax Institute	Philadelphia
Worrall, D. H.	Penn. R. R. Co.	Philadelphia

RHODE ISLAND

Arnold, Preston F.	R. I. Hospital Trust Co.	W. Barrington
Goodrich, Robert M.	Gov. Research Bur.	Providence
James, Harold W.	State House	Providence
Leahy, Edw. L.	State Tax Administration	Providence
Poole, Kenyon E.	Brown University	Providence

SOUTH CAROLINA

Beattie, A. J.	Comptroller General	Columbia
Bradley, W. R.	Director S. C. State Income Tax	Columbia
Craig, A. B.	S. C. Tax Commission	Columbia
Crouch, Thos.	Southern Bell Tel. Co.	Columbia
Howell, Thos. M.	S. C. Tax Commission	Columbia
Parker, Miss Sarol	Comp. General's Office	Columbia
Query, W. G.	Chairman, S. C. Tax Comm.	Columbia
Smith, J. M.	State Auditor	Columbia

SOUTH DAKOTA

Bottum, J. H. Jr.	Director of Taxation	Pierre
Cosgrove, F. N.	Tax Dept.	Huron
Feldhaus, Gordon	Deputy Dir. of Taxation	Pierre
Mintener, Benj. D.	Asst. Atty. General	Pierre
Wilder, W. R.	Div. of Taxation	Pierre

TEXAS

Corbett, John M.	Texas Gulf Sulphur Co.	Bay City
Dillon, Chas. H.	Western Union Tel.	Dallas
Gilbough, F. M.	Land & Tax Comm.	Dallas
Gilbough, Mrs. F. M.		Dallas
Hammermann, John Jr.	Gulf Oil Corp.	Houston
Matthews, D. B.	Shell Oil Co.	Houston
Lansdale, Col. John	So. Pac. Lines	Houston
Lansdale, Mrs. J.		Houston
Plank, E. H.	Texas Tech. College	Lubbock
Plank, Mrs. E. H.		Lubbock
Webb, Harry C.	Texas Gulf Sulphur Co.	Houston

UTAH

Bennion, Heber Jr.	State Tax Commission	Salt Lake City
Brown, C. M.	Utah Copper Co.	Salt Lake City
Brown, Mrs. C. M.		Salt Lake City
Gibson, J. Lambert	State Tax Commission	Salt Lake City
Harris, M. H.	Utah Taxpayers Assn.	Salt Lake City
Sawyer, E. M.	Union Pacific R. R.	Salt Lake City
Sawyer, Mrs. E. M.		Salt Lake City

VIRGINIA

Blough, Roy	U. S. Treasury Dept.	Arlington
Keehne, Wm. F.	Appalachian Elec. P. Co.	Roanoke

Owen, Wilfred	Nat. Resources Planning Bd.	Arlington
Schwartz, Hugo C.	Dept. of Agriculture	Alexandria

WASHINGTON

Cumming, James R.	C. M. St. P. & Pac. R. R.	Seattle
Cumming, Mrs. Jas. R.	1119 E. John St.	Seattle
Garing, Fred	Great Northern Ry.	Seattle
Garing, Mrs. Fred		Seattle
Jenner, T. M.	Washington Tax Comm.	Olympia
Jenner, Mrs. T. M.	3117 Capital Blvd.	Olympia
Leslie, Mrs. Frank E.		Spokane
Smith, W. C.	N. P. Ry.	Seattle
Smith, Mrs. W. C.	820 Smith Tower	Seattle

WEST VIRGINIA

Conaty, W. J.	Chesapeake & Ohio	Huntington
Conaty, Mrs. W. J.		Huntington
Frasure, Carl M.	W. Va. University	Morgantown
Moir, G. B.	Am. Gas & Elec. Co.	Charleston

WISCONSIN

Alexander, C. K.	Wis. Taxpayers Alliance	Madison
Barlow, Elmer	Tax Commissioner	Madison
Broadfoot, G. L.	Wis. Board of Tax Appeals	Madison
Brown, Wm. E.	Allis Chalmers Mfg. Co.	Wauwatosa
Ely, Arch	Citizens Pub. Ex. Survey	Madison
Heavenrich, Max P. Jr.	City & Co. Economy Assn.	Superior
Heck, Erhard E.	Allis Chalmers Mfg. Co.	West Allis
Heller, Walter W.	Univ. of Wisconsin	Madison
Herman, Roman O.	City of Manitowoc	Manitowoc
Holloway, C. S.	Wis. Taxpayers Alliance	Madison
Libman, Jerry	H. Libman & Co.	Wausau
Libman, Mrs. J.		Wausau
Mirman, Jacob	Mirman Furniture Co.	Wausau
Mirman, Mrs. J.		Wausau
Reynolds, Paul N.	Wis. Taxpayers Alliance	Madison
Slater, Harry	Wis. Board of Tax Appeals	Madison
Wegner, A. E.	Dept. of Taxation	Madison
Wehrwein, George S.	Univ. of Wisconsin	Madison
Wendt, Mrs. A. M.	Hotel Wausau	Wausau
Witte, Edwin E.	Univ. of Wisconsin	Madison

WYOMING

Ewoldsen, Archie	Board of Equalization	Cheyenne
Ewoldsen, Mrs. A.	3523 Central Ave.	Cheyenne

CANADA

Bieler, J. H.	Treasury Dept.	Quebec
Garson, Stuart S.	Treasurer of Manitoba	Winnipeg
Howes, Joseph E.	Bank of Canada	Ottawa
Lowther, James H.	Dominion Bur. of Stat.	Ottawa
Shink, G. H.	Comp. Prov. Revenue	Quebec
Wynne, C. G. M.	Sun Life Assur. Co.	Montreal

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